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CENTRU ANALITIC INDEPENDENT

MOLDOVA 2009: STATE OF THE COUNTRY REPORT

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Executive summary


Resources for development

By and large, Moldova's geographic and natural endowment is not conducive to an effortless long-term development. Because of lacking easy access to the sea and due to its poor transport and customs infrastructure, Moldova has not been able so far to get any close to its much nurtured dream of becoming a bridge between East and West. While some on-going technical projects are likely to open Moldova a bit more to the international trade and transport, the country needs impeccable trade and transport regulatory environment and much more infrastructure investment in order to not being totally overrun by its main regional competitor, Ukraine. Moldova has got a good endowment of only agricultural resources, including fertile land and relatively propitious climate, but other countries in the region are equally or even better equipped with such resources. In order for these natural resources to serve the country's long-term economic development, Moldova has to properly manage and protect its soil, adapt to the more volatile, but on average hotter and drier, climate likely to dominate in the not-so-distant future and make more efficient use of its limited water resources. A key economic and geopolitical constraint for the country is lack of own energy resources on the one hand and the low level of the energy efficiency across the economy and society on the other.

Human resource is the most valuable asset that the country has yet to fully make use of in order to set on a sustainable development path. Moldova has a two decade-long history of losing its high-skilled human capital and still continues losing it through migration. No doubt, unless labor productivity and salaries converge faster to the average level of Central Europe the migration will remain the most attractive career option for the most educated Moldovan youth. Poor and insufficient productive capital remains the key constraint undermining labor productivity. Moldova needs much bigger volume of public, private and foreign investment in order to close its technological and productivity gap with other countries in the region and to get rid of its geographical curse. Another key point, discarded so far by the domestic policy practice, is that with insufficient and little diversified natural resources Moldova has to get highly efficient in using its domestic (soils, water, some minerals) and imported (energy) resources.

Economic policy for development

The Moldovan version of the economic policy has traditionally encompassed a set of arbitrary and opaque administrative practices enabling the government to effectively control the business. An overextended system of state control bodies, a vast and inefficient public administration and a pervasive system of pecuniary payments and imposed social responsibility conspired to undermine the domestic private sector. What is particularly worrying is that private companies apparently got accustomed to this way of doing business and there were no systematic protests against it. After the initial macroeconomic debacle in early transition period, Moldova has achieved some sort of macroeconomic stabilization by 2000-2001. Achieving more of it was precluded by high public budgetary commitments of the Moldovan government (comparable to OECD average in relative terms) and lack of necessary institutional and structural measures to redress inflationary pressures. Moldova has got a rather underdeveloped financial system which is unable to amass domestic savings at reasonably low costs to transform them in long-term deposits and finance investment. Presently, the commercial banks are in rather difficult situation (even though less troubled than in all other countries in the region) because of the increasing share on non-



performing loans concentrated in two sectors (constructions and winemaking) with potentially escalating risks. Moldova has also accomplished a high level of integration in the world economy while the geographic diversification is practically similar to what gravitational trade theory predicts. However, because of the worsening terms of trade, poorly diversified exports and growing needs of a growing economy, Moldova's foreign trade has become utterly unbalanced.

Short of domestic capital and with so many innate weaknesses, it is vitally important for Moldova to become at least in institutional terms the most attractive eastern European country for the international investors. A more advanced industrial and business infrastructure is both necessary and possible to put in place using existing EU funding opportunities. Moldova has a long way to go to close its technological and productivity gap with Europe and there is no time to lose because Europe moves very fast. As human resource are the most valuable for the economic growth, Moldova has also to completely change the way its education sector "performs" in order to make valuable use of these resources and to produce specialists for the domestic economy rather than migrants ending up working on construction sites or providing low-skilled services in Europe and CIS. Educational institutions have to stop being self-sufficient and inward-looking, but rather get extroverted while developing more ties with their peers in Europe, with research community in Moldova and abroad and, whenever relevant, establish cooperation with both domestic and international companies.

Domestic politics

Moldovan society is quite diverse and heterogeneous not least because the country's history has had a very tumultuous and complex evolution. This heterogeneity if not transformed into creative synergies ushers emergence of dividing lines which make people easy prey for political manipulation and populism. Now these dividing lines (ethnic, linguistic, etc.) are as vivid as ever, while Moldova appears to have gone the full cycle of failed attempts of "nation-building" based on ethnic identities often opposed to civic identities. Besides that different communities pulled in often opposing directions by strong outside geopolitical poles, which also happen to be former metropolis. The attractiveness of the respective poles has been "nurtured" along these years by successive policy failures of Moldovan political class. Continuous failure to deliver on basic obligations by Moldovan state as well as perpetuation of "ethnically"-colored political discourse will make the "nation-building" quest more and more elusive.

Furthermore, this failure coupled with detachment of political process from ordinary peoples' expectations leads to public disenchantment with politics and open or hidden dissatisfaction with the way the country develops and way it is governed. At the same time, majority of Moldovans feels their opinions do not matter in the decision-making process, lacks interest in politics, doubts correctness of the electoral process and has no trust in political parties. In 2009 this uninspiring combination flavored with such ingredients as suppression of opposition groups and media, aggressive electoral campaigning and manipulations, as well as economic hardship, led to the biggest social unrest since the late 80's. In a sense, the April 2009 events shattered not only the most important governmental buildings, but also any persisting illusion with respect to the state of Moldovan democracy and governance. The repeated elections that led to the emergence of coalition government offer new hope for Moldova: different quarters of political class as well as different social groups in Moldovan society will have to learn how to communicate to each other and to seek consensus on public policy matters for the sake of Moldova's development. This hope should not be wasted.

Foreign policy

As any small country, Moldova is subject to influences of bigger geopolitical players and it is also a place where interests of these players meet or collide. Adding another twist to this picture is

the fact that Moldova's aspirations are closely related to one or another center of power: joining EU or returning to the "Russian" world. Furthermore, Moldova's foreign policy cannot be fully untied from the reality: there is a series of constraints varying from economic ties to fluid global and regional geopolitical context. Moldovan diplomacy should be indeed the art of the possible.

Indeed, Moldova is strongly connected both to the EU and Russia via trade and investment. Russia is the main destination for Moldovan exports on the country level, while more than half of all Moldovan exports goes to the European market. Most of FDI coming to Moldova comes from the EU, while Russia also holds important share. Furthermore, Moldova's energy supply is highly dependent on Russia, while integration in the European energy architecture is the only viable alternative for Moldova.

The other major connection is labor migration: Russia and the EU are main destinations for Moldovan labor migrants, meaning that these are places of origin of remittances that help keeping Moldovan economy afloat.

The intimate ties do not stop here, however. Both Russia and EU (increasingly) hold key for territorial reintegration of Moldova; as well as hold significant influence over the minds of Moldovans through mass media, Church and development aid, while European integration has seemed to be a *zeitgeist* in Moldovan public discourse. No surprise, the public perception on the country's present and future is quite blurred: slight majority of Moldovans see Russia as the main strategic partner much ahead of the EU, but roughly two-thirds of Moldovans would vote in favor of the accession to EU. EU-supporters should not be enchanted by this overwhelming support for their cause; almost 44% of Moldovans would vote re-unification under auspices of a reformed and modernized Soviet Union. Easy to see, at least 10% of the population would vote for two (or more, if available) unification options at a time.

Certainly, these are not the only foreign policy constraints. The international and regional geopolitical landscape has been increasingly fluid of lately. Within last couple of years, the leading geopolitical player, the US, has become somewhat disentangled from the processes in the former Soviet periphery and has also tried to reset relations with Russia. Russia itself has become increasingly assertive abroad, while its interests towards former Soviet Union countries are also on the rise. At the same time EU has started implementation of the Lisbon Treaty which requires more concentration on internal institutional issues, while its members appear sometimes divided on foreign policy issues. Furthermore, this year will find Ukraine, an important neighbor of Moldova's, in post-electoral transition towards a more Russia-friendly political regime. On the western side, spurred by the establishment of the much friendlier government in Chisinau and electoral victory of its fervently pro-Atlantist president, Romania's role seems to be on the rise. And not to forget, the world is still at pains to shrug off the repercussions of the global financial meltdown and this fact weighs heavily on the foreign policy decisions taken by the global and regional actors.

All this as well as heterogeneous nature of governing coalition will require a balanced and cautious approach both to foreign and domestic policy decisions, bearing the overarching goal of European integration in mind.

Global challenges

The future is inherently uncertain. The future of a small country is "uncertain+" as such countries often lack resources and power to influence and mitigate the global challenges. This report outlines four main global challenges for Moldova, although the list may well vary as time goes by. These challenges are: global economic crises, climate change, food shortages, and eventual global energy run-out.

On most of accounts Moldova finds itself at the receiving end, nonetheless, it will have to deal with consequences of these challenges.

Take first the global economic crisis of 2008. Not only it represented the worst economic development on the global scale since the Great Depression, it also shattered the foundations on which was laid the global economic order as we know it. A series of open questions remain over the way the global economy will look like in the near future. The impact of the crisis does not end with the economy; it also spills over into the realm of geopolitics shedding light on some important shifts in the global balance of power. The scale of these risks is no doubt beyond Moldova's powers; however, searching at least some adaptation solutions is a necessity. These solutions should not be limited to but may include: establishment of the special emergency fund to deal with first-hand impacts of the future economic crises, putting forward new industrial policy and making better use of foreign aid.

Further on, climate change has already made the headlines both in Moldova and abroad. Make no mistake the challenge posed by climate change is daunting. Moldovan climate is expected to become hotter and dryer, while extreme weather events – to intensify. But again, mitigation solutions are to be found mostly on global level, while adaptation solutions are to be found mostly by domestic actors. These adaptation measures should not jeopardize or derail Moldova's development plans and take into account limited resources at hand. Therefore, the tentative solutions should center around efficient use of available resources and investment in key infrastructure able to withstand the future climate pressures and be supported by stronger international involvement on that matter.

Another ominous development of recent years has been price hikes for food. Indeed, in 2002-2008 global food prices expanded almost two-fold, retreating somewhat in the aftermath of global financial crisis of 2008. More numerous and richer population, re-direction of agricultural resources towards energy production, more expansive inputs, commodity market frenzy, as well as years of neglect in agriculture at global scale have all contributed to this state of affairs. For Moldova, as agricultural country, such a development is not necessarily a bad thing. However, in order to benefit from this development and offset the adverse impact of such developments as more expensive fertilizers, soil degradation, convoluted market structure and others, Moldova needs to improve on two accounts: production and market access. New land use practices should be employed, agricultural inputs from new crop varieties to disease-resistant livestock should be enhanced, and market structure should be reassessed and streamlined.

The oil run-out and sprawling energy prices is yet another fear haunting the world. The robust growth of world economy led to growing demand for black oil, leading to much higher prices for oil and energy resources in general. Nonetheless, not only rocketing demand is to blame. Lower investment in oil industry and lower output are also at play, while commodity market exuberance and politicization of the energy issue poured more oil to the fire. Thus, the expensive energy seems to be a long-standing reality. At the same time, Moldova is poor in energy resources importing over 90% to satisfy its needs, while the supply of energy is not diversified. In order to come on terms with this situation, Moldova's approach should be two-fold: limiting external vulnerabilities by increasing local production and changing the mix of energy used and diversifying supply. Smaller components might include small-scale hydro-power generation and renewable energy development, energy efficiency and conservation (both equipments and buildings), shifts in tariff policy and switch to more use of power instead of natural gas. Integration with the European energy networks (both power and gas) should also be vigorously pursued.

This report shows that Moldova faces daunting tasks of alleviating the plethora of its innate weaknesses. As hard as they may seem, finding some solutions to these, at least for the time being, should not be seen as a "mission impossible". This report attempts to chart the sea that Moldova goes, to map out the areas where underwater stones may lie and to help it navigate the turbulent waters. In any case, we wanted to provide a palpable contribution to the general discussion on Moldova's present and future and hope this contribution may serve as a platform for further and broader debate.


Introduction

The “Moldova 2009: State of the Country Report” is the second state of the country report published by the Expert-Grup think-tank. It was developed and prepared as part of the project “Moldova 2009: State of the Country Report – How to Continue Developing in a Turbulent Global and Domestic Environment?”. The project benefited of the financial support of the Black Sea Trust (Bucharest, Romania) and the Balkan Trust for Democracy (Belgrade, Serbia).

Current political and economic situation in Moldova is of a critical nature and setting perspectives for long-term development trends in the society. The process of strengthening civil society involvement in policies development reached a decent level of maturity, with a strong potential to produce a number of adequate analyses and diagnoses of various processes in the country. Despite the need to further improve the quality of the contribution provided by NGOs, and to make their inputs more consistent and recommendations more realistic there are already plenty of examples of civil society participation in public life including changes in major problematic areas in the society. These concerns first of all are the areas of human rights, justice and economic development as well as corruption, and freedom of media. In 2009 many civil society organizations have been very active and often pro-active in all these spheres. In early 2010 a National Participation Council composed of 30 national NGOs was set up with the purpose to facilitate government’s dialogue with civil society on various policy issues. However, as civil society organizations usually look at such issues via lenses of their own mission, there is a tendency towards a rather narrow expertise and lack of a holistic vision.

This project approached the current critical situation in the Moldovan society and its most likely implications through this much needed holistic perspective. It aims at “sincere” and unbiased assessment of the country development framework, shaping country’s policy agenda and promoting policy solutions to the problems arising from the internal and external challenges, e.g. global economic, environmental and energy crisis, deficient governance, extremely weak democracy and drawbacks in economic development. Apart from being a logical follow-up of the 2007 State of the Country Report, this report will also draw conclusions from deficiencies noticed already in previous issue and will show their implication in current crisis. Last, but not least, this project aims at analyzing what influences Moldova’s development as a state and advancing innovative policy solutions to Moldova’s core problems affecting its development as a state.

Drawing on the previous State of the Country Report, this Report is much more focused and is structured in six core chapters. In the first chapter we analyze Moldova’s endowment with the resources necessary for any country to prosper and compete with other nations: labor, technology, infrastructure and natural resources. What policies have Moldovan governments adopted to overcome the country’s natural weaknesses and how successful these policies have been in supporting country’s economic growth is the subject of the second chapter. The third chapter is dedicated to a strategic analysis of the domestic political environment in Moldova, starting with deciphering the main dividing and uniting lines within the Moldovan society, going to political participation, welfare situation and ending with analysis of how robust is the rule of law. Further on in the fourth chapter we attempt to analyze the foreign policy of Moldova from the perspective of main constraints and determining factors of both domestic and foreign nature, including the very fluid geopolitical environment in the region. In chapter number five we outline the four major global risks likely to affect the Moldova’s development in near and more distant future: global economic crises, climate change, scarcer



and dearer food, and eventual global energy run-out. Based on this analysis, the final chapter draws the policy implications and makes recommendations to the Moldovan government. The appendix includes the analysis of the sociological survey “Moldova 2009: state of the country and of the people” commissioned by the Expert-Grup as part of this project to the IMAS-INC company.

Resources for development

1. Moldova 2010: assessing country's resources for development

For a country to prosper and compete with other nations, a sound and constantly developing economic basis is necessary. Economic development is ultimately a long-term social process encompassing the growth of country's productive capacities by using the resources the country can attract or is endowed with. Various factors propel economic growth, but ultimately it depends on availability and efficient combination of labor, technology, physical infrastructure and natural resources. While geographic and natural factors fall under the God's responsibility, availability and efficient use of the other factors is the result of the governmental policy and of some longer-term social and economic changes. This chapter analyzes how well Moldova is endowed with all these resources.

Ambivalent role of geography and nature

Starting with the endogenous endowment, it has to be said that the geographic situation of Moldova is more a burden for its development than an asset. Below we are looking at Moldova's main geographical parameters, endowment with basic natural resources and with energy and try to scrutinize some of the myths related to Moldova.

Geographic and demographic situation

One overplayed myth is that Moldova is strategically located between Western and Eastern economic poles and this location could be used to develop a strong logistics sector serving international trade. However, with all its transport and customs infrastructures problems, Moldova is presently everything but a logistics node. Looking at the Europe's map, one sees clearly that Moldova is landlocked, peripheral and far from bridging the West with the East. While some other European countries are landlocked either (such as the Czech Republic, Hungary, Slovakia, or Belarus), they are more central in terms of continental transportation routes and trade flows. Moldova stretches only 340 km on the 1200 km long land stripe between the Black Sea and the Baltic Sea. The country is truly sandwiched by Romania and Ukraine. The latter has 1150 km border with the "West" (Poland, Slovakia, Hungary, and Romania), while Moldova - only 450 km (with Romania). Ukraine has 16 functional airports and a dozen others that can become operational for international cargoes and 18 large sea and river ports. Moldova has only 3 functional airports and one small sea-river port. Combined with low-quality roads, slow railway and an unsettled political conflict with the Transnistria breakaway region this makes Moldova economically "remote" and unattractive as international transit route. To some extent, Moldova could be seen as a transit route for the land transportation flows between Balkans and Ukraine/Russia, but most of the international carriers prefer after entering Romania from the West or South to take a bit up North and enter Ukrainian territory immediately rather than crossing Moldova. This objective assessment of the geographical size and location implies that Ukraine by far outperforms Moldova when it comes to bridging the West with the East. Because of this size disadvantage, Moldova will have to invest much more than Ukraine and to provide a much better business and trade environment in order to become truly attractive as international logistics center.

Moldova's geographical location is strategically important more in terms of military than of international trade. The Dniester and Prut rivers are natural barriers between other two much bigger barriers: the Carpathians Mountains and the Dnieper river. With Romania becoming a NATO member, hosting four US military bases and other military facilities and declaring recently to offer its soil for location of interceptors as part of the US ballistic missile defense system, Moldova's geostrategic importance only grows. However, this should be more an issue of concern rather than of pride, because this practically means that a potential military conflict between Russia and NATO would be fought on the Moldovan territory. Protecting this territory without siding with any actor involved in a potential conflict and without entering active military operations requires either an internationally recognized neutrality status for the country or much stronger military capabilities to defend it. Another strategic option for Moldova would be joining NATO but this has a very weak support among Moldovan population and represents a contentious issue inside the political elite. This also means that Russia would prefer to remain present in Transnistria for good rather than to withdraw its troops and munitions in any foreseeable future.

Another myth is that with the Giurgiulesti port becoming operational in 2007, Moldova has finally become a maritime country. There is little doubt that the Giurgiulesti port will be quite successful project and others will try to replicate it elsewhere in Moldova by developing land-based international logistics hubs. However, the privately-managed Giurgiulesti port has presently limited operational capacity of transporting only oil products, grains and passengers and is compatible only with small sea and river-going vessels. The Danube River can become for Moldova a key transport venue to/from Europe and to/from Ukraine, Russia, Georgia, Bulgaria and Turkey, but to make efficient use of it Moldova has to develop much further the Giurgiulesti port and to make its territorial deals with Ukraine irreversible. Because of the border constraints, developing the Giurgiulesti port further is possible only upstream the Prut river but this requires additional investment which may not be feasible in the near future.

Small size of the country is frequently invoked as one of its advantages to solve quickly its core problems and eventually to get rapidly integrated into EU (as opposed to Ukraine which as size is 18 times larger). Also, Moldova has many natural sites of scenic beauty, a reference for those willing to make Moldova a tourist destination. However, small is beautiful only if it is tidy. To any foreigner getting outside the capital area, Moldova leaves an impression of a rather messy country, with people and administration showing little care about public goods and community welfare. If being small is advantage why then Moldova has not been able for two decades to get at least clean if not rich?

Moldova is densely populated, with about 116 inhabitants per km², which generates a considerable pressure on the environment. While this indicator practically matches the EU-25 average, this is much above other countries in the region; Bulgaria has 69 inhabitants per km², Romania – 94, Ukraine - 75¹. That would not be a problem in itself if Moldovan population would be mainly urban. However, most of the Moldovan population is rural and this brings us to a truly difficult problem, which is the high density of small rural communities in Moldova. Only 9 out of the 1545 communities in Moldova have more than 20 thousand inhabitants. According to our estimates, more than 55% of total population lives in communities with less than 5000 inhabitants each, and about 11% - in about 700 tiny rural communities with less than 1000 inhabitants each². This dispersion of small rural communities poses enormous problems when it comes to providing basic utilities and physical infrastructure to these communities. No surprise, in 2009 about 41% of the Moldova's citizens did not have access to running water, 55% - to sewage system, and 47% - to natural gas pipeline³. At the beginning of the 21st century, more than half of the population of this

¹ EUROSTAT statistical database;

² Expert-Grup estimates based on the Moldovan governmental "Devinfo" database;

³ According to the results of the sociological survey "Moldova 2009: state of the country and of the people" conducted for Expert-Grup by IMAS-INC Chisinau;

European country still uses wood stoves and latrines as part of “normal” life. These shortcomings are only magnified by the weak administrative and policy capacities of the local administration and uncooperative nature of relationship between the central and local governments.

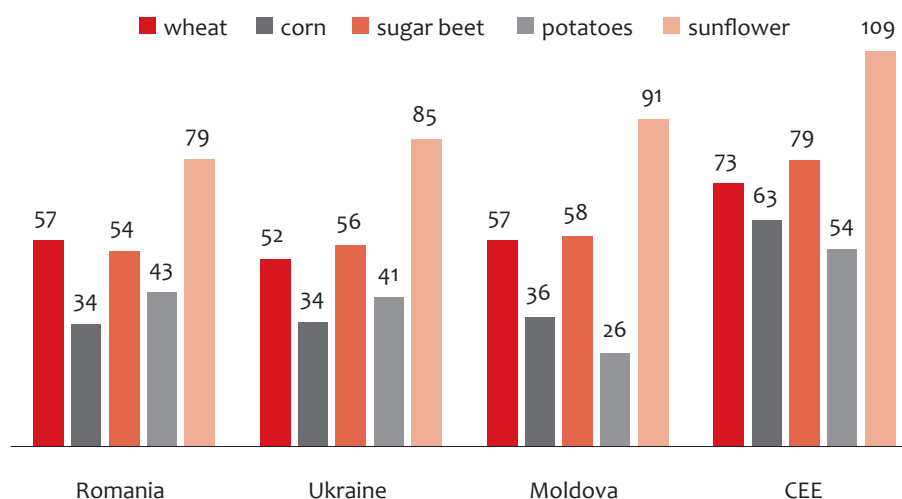
Soils and water

With agricultural land representing more than 74% of Moldova’s territory (50% on average in EU-25, but 71% in Ukraine and 60% in Romania), agricultural resources are certainly among the most important natural resources of the country. Fertile soil of Moldova is often quoted as being its main fortune. About 73% of the total arable land is the so-called chernozem, a type of soil containing very high share of humus and with high productive capacity¹. These indicators suggest that the country’s economy will probably always rely on agricultural sector more than most of the transition countries. This also means that Moldova is naturally very well endowed to ensure its own food security and even to become an important regional exporter of food.

However, with its exceptional soils, Moldova pleaded for international support to withstand the 2007 drought. Therefore, the advantages of this agricultural endowment are neither constant nor absolute. Firstly, the quality of the Moldova’s black soil has worsened in the last four decades, and this was mainly because of the man-made causes. Presently, one quarter of the total land area suffers of some form of erosion. On the aggregate soil quality scale ranging from 1 to 100 points, the rating of the Moldovan soil declined from 70 points in early 1970s to 63 points in 2008². With the rate of decline speeding up since mid-1990s, in about 20-30 years Moldova’s soils quality will get from superior to average.

Secondly, Moldova has never been able to convert the high fertility of its soils in something more palpable, such as high income for its farmers. In fact, yields in Moldova have been constantly under-par by the regional standards, although the EU-15 and CEE countries have soils of lower quality (Chart 1).

Chart 1 Basic crops yields, 100 kg per hectare, % of EU-15 average, 2008



Sources: NBS, Eurostat and EG calculations;

¹ UNDP Moldova, “National Human Development Report 2009. Climate Change in Moldova: Socio-Economic Impact and Policy Options to Adapt”, Chisinau, November 2009 (hereinafter NHDR, 2009);

² NHDR, 2009;

Furthermore, the high quality of Moldova's black soil is not unique in the region. In fact, Moldova is only a small part of the bigger Chernozem Belt stretching from Southern Romania to North-East Ukraine and further to Southern Russia. Both in Ukraine and Romania the quality of soil matches the quality of soil in Moldova, but the two other countries have much vaster arable land and are therefore more attractive for international or domestic investors preferring to make economic benefits from the opportunities provided by the large-scale agriculture. Finally, the land – which is the most valuable asset of Moldova, with a total market value that we estimate at 5-6 billion Euros – has never been part of the normal economic circuit. After two decades of economic reforms, the land market still remains dysfunctional and unattainable for the foreign investment as non-residents are prohibited by law to purchase agricultural land.

Despite its location in temperate latitudes, Moldova has surprisingly small water resources, and these can further deplete as global warming advances. In popular perceptions, there is “a lot” of water in Moldova; hence, it is not carefully used. An indicator of this little care is the share of the losses associated with water transportation in total water withdrawals growing from 1.2% in 1980s to 4% in 1990s and 7.4% in 2000s¹. However, expressed in per capita terms, there are only about 1700 m³ water resources available in Moldova and this represents only 50% of the Ukrainian level and 25% of the Romanian one. A significant risk is that only 1/3 of the available water volume is from local resources, while the rest comes from the two trans-border water streams crossing Moldova (Dniester at East and Prut at West). While presently the water use level is quite small (1.4% of the total stream volume), the main risks are those related to potential cross-border environmental disasters. In the recent past Ukraine has shown little care for the environmental issues and little willingness to cooperate with Moldova on them; indeed, the regional floods in 2008 have been mainly an outcome of this lack of cooperation. A technological disaster on the Dniester River somewhere on the Novo-Dnestrovsk hydropower station would immediately have severe humanitarian consequences for downstream Moldova.

The limited resources of water are an especially significant economic constraint for the present and future economic growth of the Southern and South-Eastern region of Moldova (conventionally, under the Leova-Cimislia-Grigoriopol line). The region which is almost entirely dependent on agriculture is already scarce in water resources. And the region's irrigation needs are only likely to increase as climate is projected to get hotter and drier in the decades to come.

Besides limited quantity, the poor quality of water is another significant problem that presently creates big costs for the industries relying on water and generates significant risks for people's health. About 90% of the country's digging wells - which are main sources of water in all Moldovan villages - do not meet the potable water hygienic standards². Also, the water from the Bic river (downstream Chisinau) and from Raut river (downstream Balti) is of very poor quality because of the discharges from the two big cities. Among other consequences, the poor quality of the water will hinder development of a “green agriculture”, as practicing it relies entirely on efficient and non-offensive irrigation schemes. If not abated, the problem of the poor quality of the water will continue draining even more public and private resources from economic development to health care needs.

Mineral and energy resources

In the last three decades Moldova has not been part of any complex program of geological prospection. However, there is no doubt that Moldova is one of the poorest countries in Europe and CIS in terms of exploited/proven mineral resources. Traditional energy resources (such as oil, gas, coal) are practically absent with some small amounts of poor qualities and low economic

¹ Expert-Grup estimates based on NHDR, 2009;

² NHDR, 2009;

value available in Southern region. These will remain only of local importance unless deeper geological prospects prove bigger reserves. Metal ores are missing as well (except some tiny iron ore deposits close to Soroca town).

Moldova has quite large reserves of non-metaliferous minerals used mainly for production of construction materials and ceramics. However, so far these resources have had limited role in producing internationally tradable goods (except, occasionally, cement). If properly explored and with more advanced processing technologies applied, these resources could be converted in internationally competitive construction materials and new composite materials.

According to official sources, Moldova has some deposits of rare and valuable mineral resources that are not yet industrially exploited¹. Some examples of such deposits are: tripoli, which is a perfect natural abrasive used for polishing and cleaning of jewelry and fine crafts; diatomite and bentonite that are widely used in many industrial filtering applications and as industrial adsorbents; helium which can be used for various cryogenic applications; the subterranean brines discovered during oil and gas-fields prospection in Southern region and which can be used to efficiently extract iodine, bromine and rare earths. Numerous sources of potable and therapeutic mineral water are not efficiently exploited either. However, for all these resources to be economically employed the legislation on natural resources has to be streamlined and private capital be more welcome in exploiting the mineral deposits.

The lack of own energy resources is a core, truly geopolitical, problem for Moldova. This implies that, unless some technological breakthroughs happen, the country is set to remain dependent on other countries and there are quite limited options for Moldova to get rid of this dependency. Our estimates based on official sources² suggest that Moldova has the necessary natural potential to cover only up to 10-12% of its energy needs by 2020 from renewable energy resources provided that it improves two-fold its energy efficiency. However, it is clear that this option is not a panacea and Moldova is likely to remain a net energy importer in the foreseeable future, especially if economy restarts growing faster than expected. Since lack of own energy resources is one of the main Moldova's weaknesses, this is the reality that any meaningful national security strategy should consider. In long term, shortage of energy resources, especially of the electric energy, and the acute energy inefficiency are the key constraints for the country's economic growth.

Labor: quantitative losses, any quality gains?

From economic point of view, labor is a much more valuable resource than other production factors. Quantity of available labor depends on fundamental demographic trends. However, available labor resources can be determined by other factors as well. For instance, the general social-economic environment in the country can either attract immigrant labor or rather push the country's citizens to migrate abroad, and thus increase/reduce labor force. Also, at some point in time on the country's development path for the younger cohorts of the population continuing education can become a more attractive option than entering the labor market immediately after completing compulsory education.

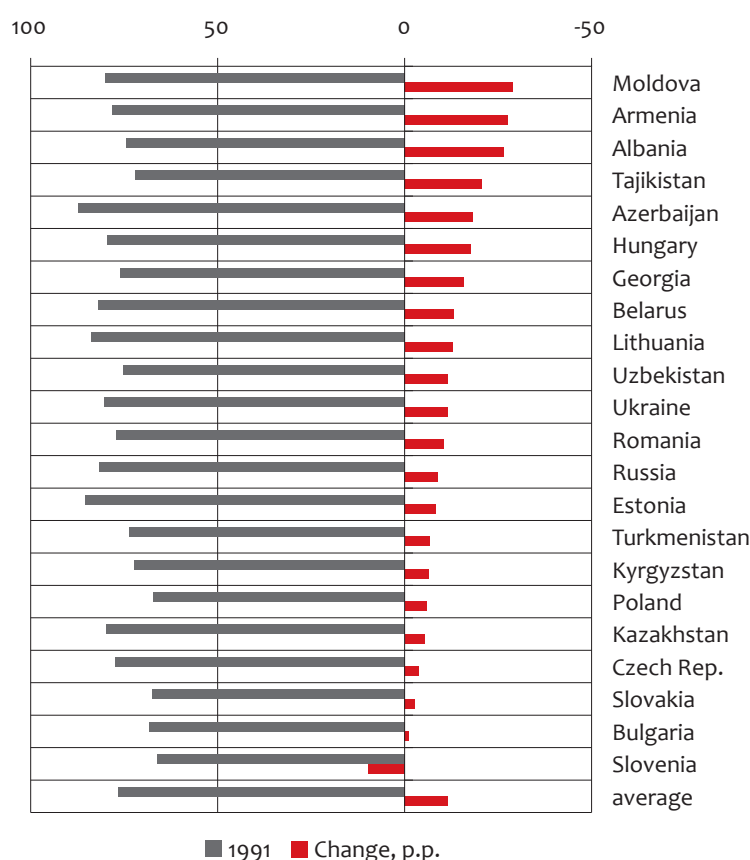
Another side of the labor resource is its quality, which changes slower than the labor quantity. The quality of the labor is mainly a long-term outcome of governmental policy in the areas of youth and adult education, but it also depends on how technologically advanced is the country in general.

¹ Ministry of Environment and Natural Resources of Republic of Moldova "State of environment in Republic of Moldova in 2006. National Report", Chisinau 2007;

² Government of Republic of Moldova, "Draft of the National Program for use of renewable energy resources for the period 2006-2010";

In terms of quantity of available labor resources Moldova has grown rapidly after the World War II, but it suffered a series of severe blows after inception of the economic transition. Separation of the Transnistria region in 1991-1992 reduced by 12% the labor manpower effectively available for the Moldovan economy in transition. Meanwhile a robust brain-drain started as well. Our estimates based on some official¹ and academic² resources suggest that by mid-90s Moldova has lost about 1000 highly-trained scientific and engineering staff that migrated abroad. Then, a massive jobs' shedding followed due to the industrial and agricultural restructuring. An important part of the highly-skilled laborers and specialists converted to „alternative occupations”, such as marketplace vendors or builders. The apex of this labor drain has been the mass emigration of the labor that set on in 2000-2001 after the Russian financial crisis boiled down to the bottom of the Moldovan economy. All in all, between 1990 and 2008 Moldova lost 846 thousand workers, or 40% of the 1989 level. Normally, that would be an outcome of a war rather than of an economic transition. Migration has also made many Moldovans unmotivated to work because of their high reservation wage, propped up by the easily available migration option. All these reflected in a dramatic fall of the employment rate. In fact, over the last two decades Moldova has suffered the most dramatic loss of labor force in the group of transition countries, as suggested by the evolution of employment rate (Chart 2).

Chart 2 Employment rate in 1991 (% of population aged 15-59) and absolute change in 1992-2007, percentage points



Sources: 2009 edition of the TransMONEE datab.ase, prepared by the UNICEF Regional Office for CEE/CIS;

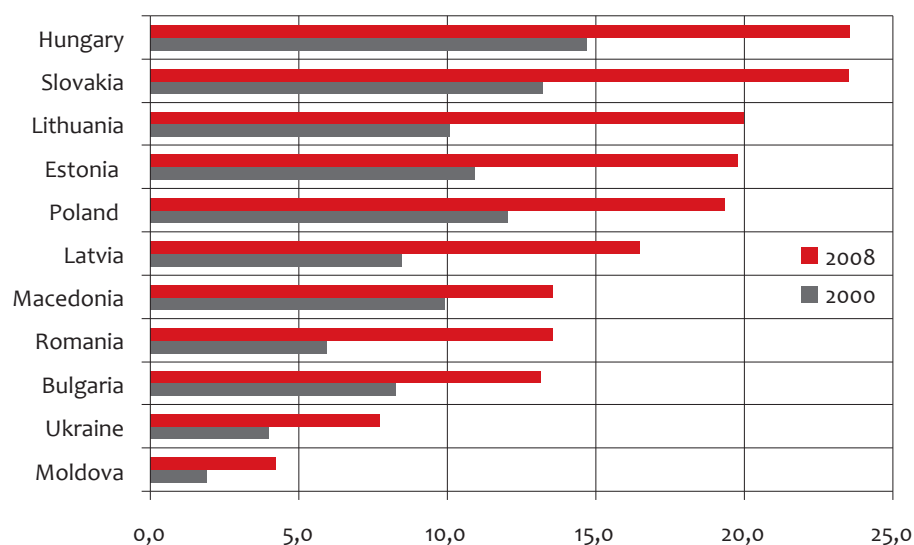
¹ National Bureau of Statistics of Moldova, Statistical Yearbooks of Republic of Moldova for the period 1993-1996;

² UNDP Moldova, "National Human Development Report 1995", Chisinau 1996;

Have these absolute losses of the Moldovan labor been compensated by an increased quality of the remaining workforce? Yes, but only to a limited extent, as suggested by the labor productivity dynamics (Chart 3). In 2000-2008 labor productivity has improved, and in relative terms, Moldova has registered the fastest growth of the labor productivity among the charted countries. Despite this strong growth, as absolute performance the Moldovan workers were in 2000, and remained in 2008 the least productive in the group of the CEE and Western CIS countries. Some illustrative comparisons follow: Moldovan workers are 5.6 times less productive than the front-running Hungarian and Slovakian counterparts, 3.2 times less productive than Romanian workers and 45% less productive than Ukrainian ones. This comparison should dismantle another Moldova-born myth related to its “industrious work force”. Moldovans are indeed very hard-working but very little productive at the same time.

Ultimately, the low labor productivity is the key factor of income poverty of citizens and of the poor economic development of the country in general. Increasing the labor productivity should be a key objective on the working agenda of any reasonable government in Moldova, regardless its ideological or geopolitical orientation. And the labor productivity should continue growing faster than in other countries in the region if Moldova is to achieve any visible income convergence with the more advanced transition countries during a generation lifetime. But how can such a performance be achieved and maintained?

Chart 3 Labor productivity, PPP-adjusted USD per employee per hour, current prices



Source: EG calculations based on Eurostat and NBS;

Labor productivity is determined by a number of factors, but the most important are professional skills of the labor and the productive capital that this labor uses. As there are no direct indicators allowing international comparisons of the labor force skills, one has to look at some general education indicators in order to try to figure out some meaningful ideas about the level of skills.

Table 1 Comparison of education enrollment rates and public expenditures for education, 2007

	CEE countries**	CIS countries***	Moldova	Ukraine	Romania
Age-specific enrolment ratio of children aged 7-14 years*	97.8	96.3	90.7	97.8	95.7
Upper-secondary education enrolment rate	88.6	55.8	47.9	57.8	88.8
Students in post-secondary education, per 10000 inhabitants	22.7	88.0	87.6	25.7	21.1
Students in University education, per 10000 inhabitants	388.6	414.7	344.1	609.1	421.5
Public expenditures for education, % of GDP	4.5	4.6	8.0	6.2	4.7

Note: * - children enrolled in different levels of education as per cent of population aged 7-14; ** - Commonwealth of the Independent States hereinafter includes Azerbaijan, Armenia, Belarus, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan; *** - Central and Eastern Europe hereinafter includes Czech Republic, Hungary, Poland, Slovakia, Slovenia, Estonia, Latvia, Lithuania, Bulgaria, Romania, Albania, Bosnia and Herzegovina, Croatia, Montenegro, Serbia and Macedonia.

Source: 2009 edition of the TransMONEE database, prepared by the UNICEF Regional Office for CEE/CIS;

Surprisingly, Moldova invests in education much more public resources than other transition countries, about 8% of the GDP (4.5% on average for the 26 transition countries for which data for the year 2007 are available¹). Besides, an important amount of private resources enter education through official or unofficial payments (bribes, contributions to repair works, handbooks rent and others). Apparently, this massive public and private spending has failed to have dramatically positive educational outcomes. In fact, educational enrolment rates in Moldova are low by regional standards (Table 1), except the enrollment in post-secondary education. Even more, the enrolment in primary education declined over the last decade by about 7%. This education levels is critical for the educational outcomes at later stages and therefore for the labor productivity.

Another essential weakness of Moldova is its rather low level of enrollment in university education (leaving apart the poor quality of the education graduates receive in engineering and management fields, which are of critical importance for any economy). This finding is opposite to the persisting stereotype that Moldova has too many University students and that the Government should channel a part of the youth to lower education levels (especially to the vocational one, which is presently in a completely disastrous situation). As a matter of fact, Moldova needs even more of its youth to graduate universities and to apply the skills inside the country. But at the same time Moldova needs a more optimal structure of the fields (with more emphasis on agriculture, technology and management) and a higher quality of studies, as well as overhaul of its system of vocational schools. Both of these ends can be achieved by allowing reputable foreign universities and vocational schools to enter Moldova, creating an efficient and impartial system of academic and vocational accreditation, monitoring closer the inputs affecting the quality of education and by increasing the Universities' and vocational schools' autonomy while rendering them more publicly accountable.

Investment: widening the gap with central Europe

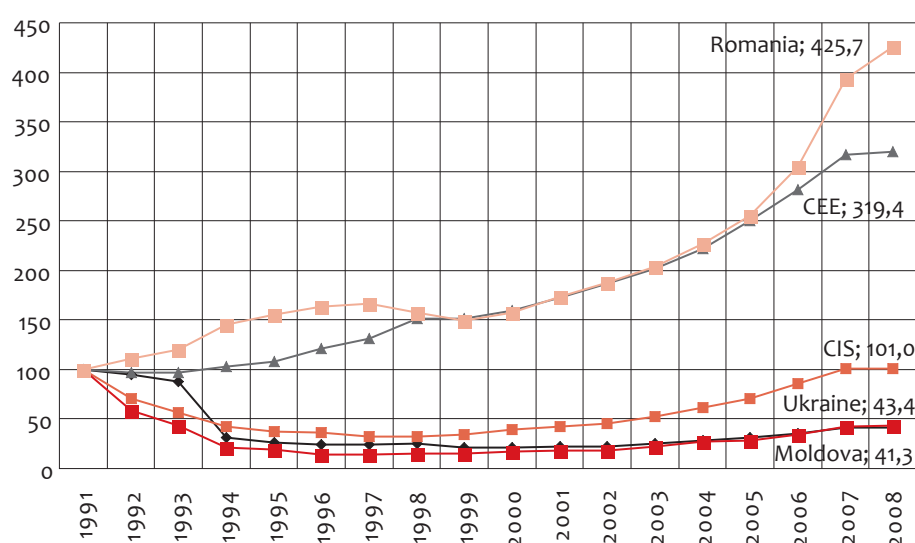
Capital investment influences both the quantity of the productive capital and its level of technological progress. Historically Moldova has suffered a chronic shortage of capital investment. After the World War II significant investments were made in all economic and infrastructure sectors

¹ 2009 edition of the TransMONEE database, prepared by the UNICEF Regional Office for CEE/CIS;

(including heavy investment in military-industrial sector). But because of the faults of the Soviet planned economy, overinvestment in technologies with military purpose and due to the supply-chains often sprawling over the whole USSR, a big share of the created productive capacities was at odds with the economic logic that reasserted itself in the wake of economic transition. An important part of this productive capital became useless once the Soviet Union fell apart.

Additionally, after becoming independent, Moldova made a strategic error of only gradually allowing private and international investors to purchase/invest in state-owned companies. In fact, in the early transition period Moldova was a laggard in comparison with both CEE and CIS countries in terms of capital investment, with a detrimental impact on the productive capacity of the economy (Chart 4).

Chart 4 Gross capital investment, index 1991=100%




Source: EBRD, IMF, EG calculations;

Because of the constant underinvestment the country's productive capital and physical infrastructure rapidly worn out during 1990s. In 2000 the real capital investment matched only one quarter of the 1991 level, but the total stock of the productive capital was even smaller because of the technological depreciation that we have not accounted for because of lack of statistical data. As of 2008 the annual capital investment was only 41% of the 1991 level. Ukraine has followed broadly a similar evolution, while Romania registered one of the most dynamic growths of the capital stock. In Moldova, an important part of the investment went to constructions, real estate and financial sector, i.e. in sectors producing non-tradable goods and thus with little impact on the country's international competitiveness.

Lack of investment capital reflected, among others, in the rapid degradation of the public infrastructure, especially of the automobile roads. With roads receiving less than 20% of the funds necessary for their maintenance, in 2006 only 10% of the total roads network were assessed as being of good or fair quality. According to respected international sources, Moldova has the worst roads and one of the worst railways among all transition countries¹. Because of the low-

¹ World Economic Forum, "Travel&Tourism Competitiveness Report 2009", available at <http://www.weforum.org>;



quality roads, we estimate that economic costs of transport inside the country are from two to three times higher than the physical distances would suggest.

By and large, Moldova's technological gap with Central and Eastern European countries widened during the transition period, while its traditional competitive advantages and markets were lost. Presently Moldovan companies are discovering new advantages and are trying to penetrate new markets. Some studies report that at least in case of some companies these efforts are monumental and that many Moldovan companies are quite competitive given the current level of country's economic development. Whether these efforts will succeed or not in long term depends not only on what companies do, but also on what the Government does through its policy.

As a net assessment to conclude this chapter, it is clear that Moldova commands a poor endowment with natural resources as compared other countries in the region. However, even existing resources are not adequately used and some of them, such as land and water, risk extensive degradation and depletion. One of the transition outcomes in Moldova was big losses of labor force, mainly because of the migration. But Moldova has done very little to maximize the productivity of the remaining labor. Finally, country's productive capital, including key transport infrastructure, has rapidly worn out because of constant underinvestment. With an ill-defined and constantly changing business regulatory environment, Moldova has frightened rather than attracting domestic and international investors. Next chapter is dedicated to analysis of the Moldova's economic policy and how this policy affected country's capacity to provide prosperity for its citizens using the resources available.

Economy policy for development

2. Moldova's economic growth: “bold” government, weak economy

Previous chapter showed that Moldova is a country relatively poor in mineral, energy and investment resource. Its human resources have depleted as well because of the on-going labor migration and poor quality of the education services. This chapter will analyze what policies have Moldovan governments adopted to overcome these weaknesses and how successful they have been in supporting country's economic growth. It starts with an overview of the transition main outcomes and then looks at how the country competed as player in the international trade. At this background, impact of the global financial crisis on Moldova is assessed.

Moldova's transition progress in nutshell

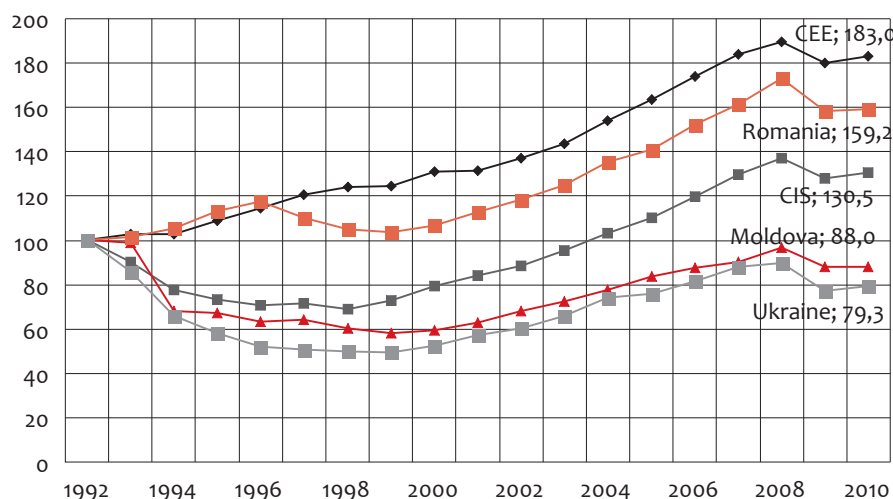
Two basic indicators are used to assess and compare countries' economic growth. The GDP growth assesses how strong economic growth has been over a certain period of time. The GDP per capita ratio (based on the Purchasing Power Parity) highlights how a country fares in terms of its population's wellbeing. The two indicators show that Moldova has yet a very large gap to close with other transition countries and this gap has only widened in the previous two decades. As highlighted in Chart 5, the CIS as a region recovered to the 1992 GDP level by 2003, while Moldova was close to recover its 1992 output only in 2008. As all existing literature shows, the labor migrants' remittances have been the main driver of the economic recovery in Moldova through supporting the private consumption. However, with a 7% decline of the real GDP estimated for 2009¹ and a rather slow 1.5% recovery expected for 2010, it is clear that the global financial crisis has put an end to Moldova's recovery. Moldova's path mirrors the evolution of the Ukrainian economy, while the other neighbor, Romania, has enjoyed a much stronger growth.

The slowness of economic recovery has dramatically affected the people's wellbeing, lowering Moldova's poverty rank in the group of the transition countries. In 1992 its PPP-based GDP/capita was only 1777 USD and this was the bottom fifth position among all transition countries. By 2008, when Moldovan GDP reached its transition maximum, the country's GDP/capita was only 2983 USD and this was the bottom third position among all CIS and CEE countries². True that Moldova managed to drastically reduce the poverty incidence rate from about 70% in late 1990s to about 30% by 2004, but this progress was achieved against a very modest national poverty line (about 50 USD per month). More important, in 2005-2008 the poverty almost stopped falling while in 2009 it grew again due to the financial crisis and economic recession.

¹ Presentation made by the Deputy Prime-minister of the Republic of Moldova, Minister of Economy, Mr. Valeriu Lazar, at the roundtable “There are good chances for the economic stabilization turning to economic growth” on February 4, 2010, <http://mec.gov.md/node/1856>.

² Expert-Grup estimates based on the IMF World Economic Outlook Database;

Chart 5 GDP growth, index 1992=100%



Notes: CIS – Commonwealth of Independent States, CEE – Central and Eastern Europe;
Sources: IMF World Economic Report database;

Worth mentioning, after 2005 there was insignificant reduction of poverty in rural areas, while urban poverty declined steadier. With the modest inter-sector relocation of labor force that we have seen so far and dysfunctional social protection system, it seems that from now on a significant reduction of poverty incidence in Moldova will be possible only if a sustainable economic growth is achieved in the agricultural sector. The latter employs about one third of the labor force and provides at least partial subsistence means to about half of the population. In the longer-term perspective, however, reduction of poverty will be possible only with more rural labor being employed in non-agricultural activities. In the early transition period agriculture bore the brunt of unsuccessful economic reforms, while under the communists' governance it was the victim of a completely flawed policy. The sector evolved from a constant economic recession in 1990s to stagnation in 2001-2008. As result, agriculture downgraded from being the most important economic sector in mid-1990s to a minor one nowadays (Table 2). Manufacturing sector has followed a broadly similar path, and this was mainly because of the drastic shortage of capital investment in the productive capacities and in the R&D activities.

Table 2 Structural and absolute dynamics of the Moldovan economy

	Share in GDP, %		Share in employment, %		Share in total exports revenues, %		average annual production growth, %		
	1995	2009e	1996	2009e	1997	2008	1995-2000	2001-2008	2009
Agriculture	33.0	8.7	42.8	32.5	15.3	11.7	-0.6	-0.1	-9.8
Industry	28.2	15.6	11.7	12.3	68.6	53.9	-4.0	7.6	-22.2
Constructions	4.0	5.2	3.3	6.8	-	-	-10.3	18.0	-30.7
Services	34.8	72.3	42.2	48.4	16.1	34.5	8.1	12.1	-3.8

Sources: NBS, NBM and EG estimates and calculations;

After the drastic collapse in 1995-2000 the constructions sector experienced the fastest growth in 2001-2008. Its share on the labor market doubled, while its contribution to GDP increased from 4.0 to 5.2%. But this growth reversed when in 2009 the real estate bubble imploded as result of falling remittances which in the past have fed a significant proportion of end- and speculative

demand for the real estate. Emergence of services as Moldova's main economic sector is the only truly positive economic development in the last decade and half. The net result of this bogus "economic modernization" has been a massive outflow of Moldovan citizens to foreign labor markets. Moldovan migrants have been among the Moldova's most competitive exports so far.

Starting with 2005-2006 the economic growth exhibited obvious symptoms of overheating. The real estate price rose rapidly without any similar trend in the revenues of the population. Bank credit in 2007 grew about 52%, while the current account reached -16% of GDP, and worsened even more in 2008, -17.3% of GDP. Even if no international crisis occurred in 2009, a domestic one would eventually hit the imbalanced Moldovan economy.

Economic policy of the "bold" government

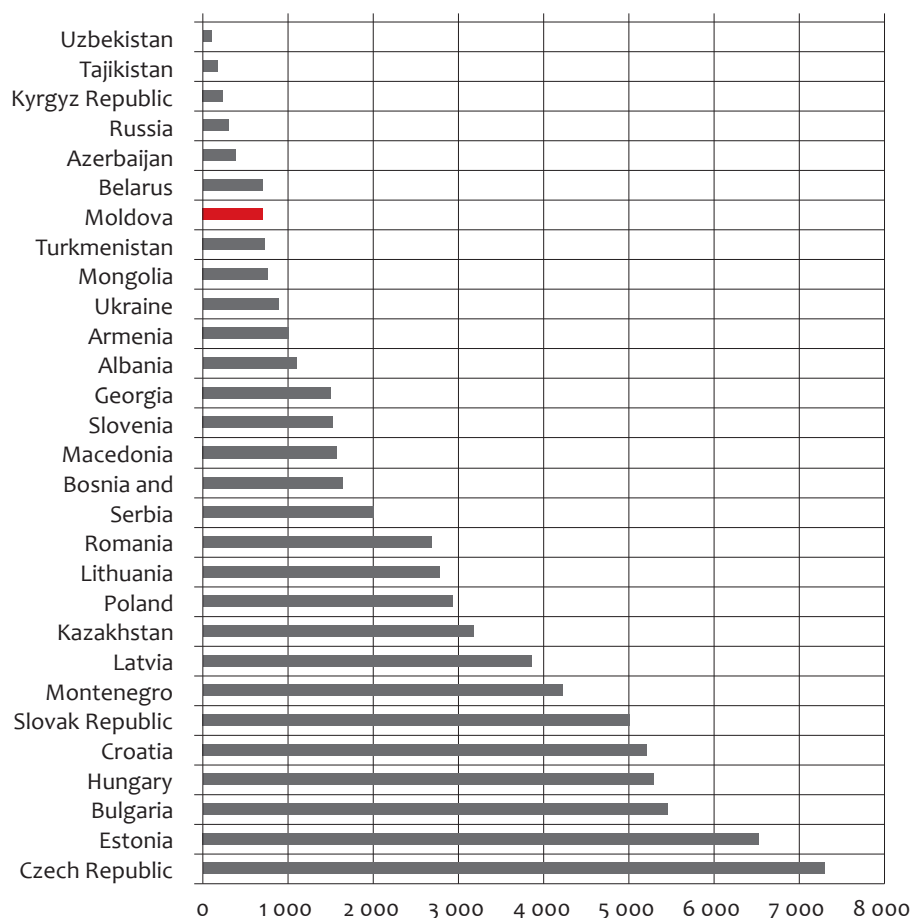
Despite liberalization rhetoric, the quintessence of the Moldovan political economy thinking in the last two decades was quite simple: the government has to control as much as possible and to lead the economy because entrepreneurs are either helpless or ill-intentioned. The practical application of this philosophy has been a vast, corrupt, pervasive and inefficient system of state control bodies and a crony system of public administration. The net result of this has been the repression of private entrepreneurship and intertwining of political goals with economic interests. Ever growing migrants' remittances provided the necessary turf for the government to fill its coffers by taxing consumption: in 2008 taxes on consumption (VAT and excises) provided 66% of the Moldovan state budget (45% in Ukraine and 57% in Romania).

During its long-lasting economic transition Moldova has implemented a string of successful reforms (such as macroeconomic stabilization, prices liberalization) but a number of critical reforms addressing structural and institutional weaknesses of the economy have been abandoned mid-way or completely ignored. To mention only one of the most important failures, Moldova has been a laggard among other European transition countries in implementation of regulatory and enterprise reform. As most other transition countries, Moldova has completed rather successfully the privatization of the small enterprises. But a real problem for Moldova is the inefficient functioning and lack of industrial and management restructuring of the large manufacture and service companies, including many public utilities. Most of these big companies continue operating under Soviet industrial standards and old management practices; they are not publicly accountable and are ultimately a drain of budgetary funds, thus locking in vast human resources and impeding country's economic development. Two typical examples are "Moldtelecom" (state-owned telecommunications services provider) and "Căile Ferate ale Moldovei" (railway transport company); both companies have used the key infrastructure they own in ways prohibiting development of private services providers. Use of state-owned public utilities for achieving political purposes has been a recurrent practice in Moldovan politics. At the same time, many market institutions are either missing or feeble: for instance, National Agency for the Protection of Competition has been set up only in 2007 but the agency remains weak and inefficient. Equally important, the country's judicial system has been chronically unable to enforce rule of law and protect firms, investors and employees rights. Growing share and number of Moldovan plaintiffs reaching European Court for Human Rights and claiming economic justice is the most telling indicator of this poor law enforcement.

A rent-seeking regulatory system was put in place in Moldova generating corrupt practices, rising transaction costs and thus making the country even less competitive in attracting foreign investments. To give only a typical example, for a domestic or foreign investor to build an agricultural products' storing/processing facility near the field it will take, in the best case, about one year while the government adopts decision of changing agricultural destination of the land and another year to get the construction permit. Moreover, Moldova has been the place of completely wicked practices when, for an investor to invest in a given community/district, the

mayor/district authorities would demand a bribe rather than providing necessary support to the investor. Moldovan government tried to improve the investment climate in ad-hoc manner rather than on systematic basis. The most monumental of these efforts was adoption of the zero-rate on the reinvested corporate income since January 2008. The then-president Voronin explained his decision by necessity to create an attractive environment for the domestic and foreign investors, even though the business surveys at that time were clearly showing that main problems were by no means those related to income tax burden but rather high costs of fiscal administration¹.

Chart 6 Stock of Foreign Direct Investment in 1989-2008, USD/capita



Sources: EBRD;

Because of this quagmire of regulatory malpractices, in the last two decades Moldova was not able to attract/generate necessary investment resources in order to make use of its most valuable resources, land and human resources. Moldova has been one of the worst performers in Central and Eastern Europe in attracting FDI (Chart 6). As result, Moldovan private companies represent today a rather depressed and weak sector, generating only 65% of the GDP. This is on a par with Belarus and Central Asia countries with a poor record of economic reforms, but very low when benchmarked against most of the European transition countries: 70% - in Slovenia, Romania, Latvia; 75% - in Poland, Lithuania, Kyrgyzstan, Bulgaria, Croatia; and 80% in Slovakia, Hungary, Estonia, Czech Republic.

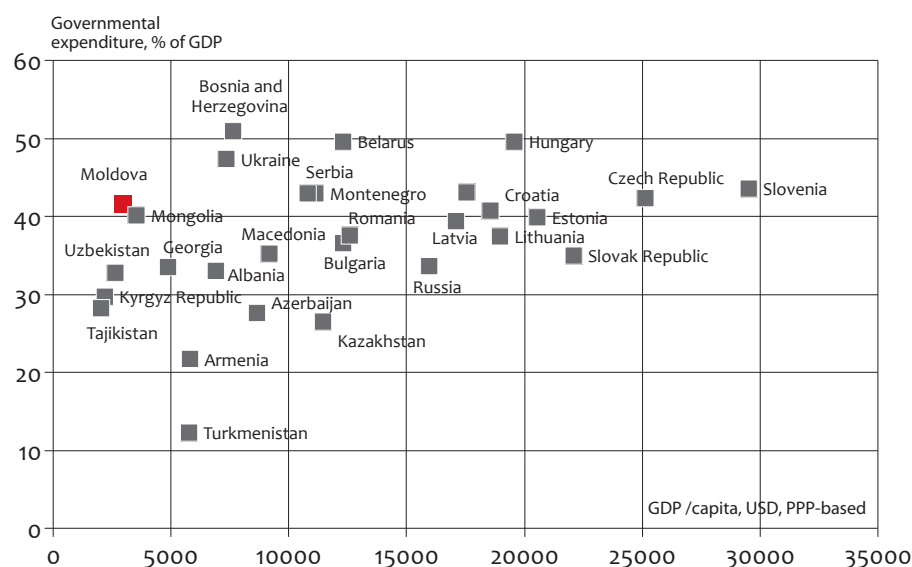
¹ See for instance the World Bank "Doing Business 2008", available at www.doingbusiness.org.

Assessment of the macroeconomic environment

After the macroeconomic chaos in early 1990s, Moldovan governments have promoted sounder macroeconomic policies. As a testimony of the improved financial discipline, in 2000-2008 the general government balance in Moldova (on average -0.3% of GDP) was much better than on average per group of transition countries in the same period (-1.3% of GDP). Running such small deficits was not an exaggerated fiscal discipline, taking into account that inflationary pressures in Moldova (13.3% as yearly average in 2000-2008) were higher than in other transition countries (10% on average per period for all transition countries). Also, Moldovan government was not credible enough to easily access international financial markets in order to cover potentially larger deficits. Despite the relative fiscal balance achieved, fiscal risks for the Moldovan government remained high because of imprudently high fiscal commitments: in 2008 the share of total public expenditures in GDP reached 41.6%, while for 2009 it was projected at 46.8%. Wages contribute to both high level and substantial increase in public expenditures in 2009, while investments had a depressed share in total expenditures. Such levels of budgetary commitments are more common to the wealthier transition countries rather than to the low-income ones (Chart 7). At the end of the day, overexpansion of the public sector resulted in crowding out of the private one.

Little surprise that for Moldova the immediate impact of the global financial crisis was the budget deficit escalating from -1% in 2008 to -9% in 2009, as the government was not able to radically cut its high level of spending at the background of plunging revenues. With a very high shortage of domestic resources to cover both fiscal and external imbalances, Moldova is set to rely largely on the IMF and other international financial institutions and donors in the next 2-3 years.

Chart 7 Governmental spending (% of GDP) and GDP/capita (current prices, PPP-based), 2008



Sources: EBRD

High, double-digit, inflation was another routine feature of the Moldovan macroeconomic environment during the entire transition period save the year 2002 when prices grew 5.2% on yearly average. The anti-inflation policies were not as tight as declared, and in fact the National Bank of Moldova had no clear-cut monetary policy strategy and no effective tools to counter inflation growth. On the other hand, the government had admitted accumulation of more than evident price distortions: food in Moldova became unbelievably expensive for a country with

“agricultural traditions”, while the prices for services, particularly for housing services, central heating, water and transport services were artificially kept below cost-recovery levels. Repressing price adjustments, especially in energy sector, contributed to accumulation of a high level of private foreign indebtedness, which created risks of turning out public if debtors turn insolvent. In January 2010 the services tariffs were more or less adjusted; but downward adjustment of the food price is yet to be accomplished.

All in all, in the last decade, the consumer prices in Moldova grew more than two-and-half times (more exactly 261.5%, see Table 3), with some services and merchandises registering much higher growth rates. The table below shows also the top-10 consumer services and goods that contributed the most to the CPI growth starting with those having the largest contribution (as they all have different shares in households' expenditures, smaller price increases may have translated in bigger net effects on general CPI). Their combined effect on the CPI growth is 47%. The implication of the table below is the following: besides the classical argument of monetary base expansion, other factors that have driven high inflation in Moldova in the last decade were weak markets competition (meat, medicines, fish until recently), poorly performing local industries (fruits) and, especially, growing imported energy price (hot water provision, gas provision, central heating and passenger transportation).

Table 3 Price indexes in Moldova, 2009, index 1999=100%

	2009
Consumer services	266.3
Food stuff	256.4
Non-food merchandises	254.4
Consumer Prices Index (CPI)	261.5
including, main contributors to CPI growth	
meat and meat products	452.0
medicines	375.3
clothes	271.1
hot water provision	1280.4
hygiene and cosmetics	315.2
gas provision	389.7
fruits	747.1
sugar	270.6
central heating	346.3
passengers transportation	340.4

Sources: NBS; EG calculations;

It is difficult to imagine how a standard monetary policy based on neoclassical theory would reverse rise in production costs due to the country's energy dependency, make agriculture more efficient or get rid of anti-competitive market arrangements. Countering in long run the inflationary pressures in the economy requires therefore not only the standard monetary tools but also a blend of structural and institutional policies to make markets functional and economy more energy efficient. And for the monetary policy itself to be efficient and Central Bank signals embedded in the commercial banks behavior, the country needs a much more developed financial system.

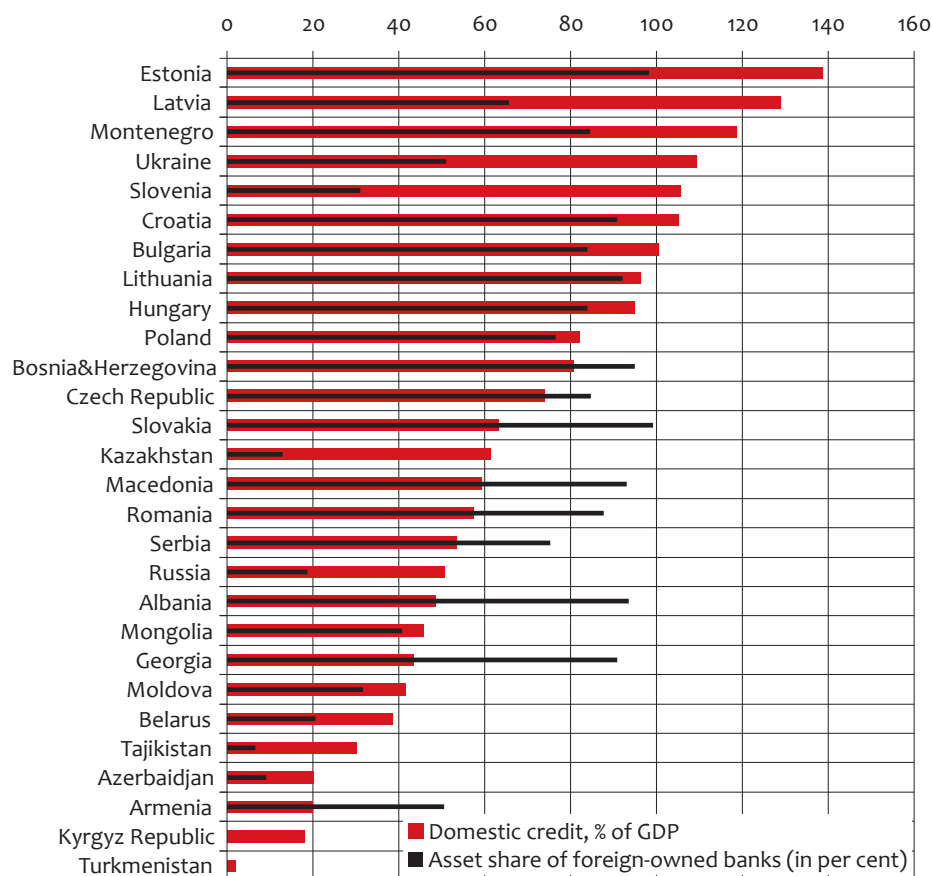
Financial sector reaping fruits of economic growth

Financial systems have a central role in promoting economic growth by offering investment resources needed by companies, and by financing mortgage schemes and long-term consumer expenditures. This is why it is important to have a look at whether and how Moldovan financial system contributed to the country's economic growth.

Moldova has a rather underdeveloped and opaque financial system, even though it was rather stable and not subject to any severe crisis in the last decade. Despite its creation back in mid-90s and its institutional correspondence to the Western standards, the national capital market plays a less than negligible role in financing companies' investment needs. Insurance services and micro-financing organizations are as depressed as the capital market.


Banking system is the main pillar of the Moldovan financial system, with total stock of banks loans representing a little more than 41.6% of the country GDP in 2008 (Chart 8). However, this is a very low level of financial penetration even for the low standards of the transition countries (where the group average in 2008 was 67.5%). Main part of the capital investments in Moldova – more than 50% in 2008 and 58% in 2009 after banks rationalized the credits even more – is financed by companies own profits, which is an unusually high indicator. The 2009 financial crisis had a severe impact of financial situation of the Moldovan companies and most of them will not be able to finance their investment plans on their own. This is why, besides attracting more foreign capital, Moldova needs to get its banking system at least as functional as before the crisis in order to provide necessary investment resources. Otherwise, the economic recovery will be a lengthy and difficult one. The main problem is that banks themselves are presently in a difficult situation either.

Chart 8 Financial depth and ownership of the bank sectors, 2008



Source: EBRD;

The Chart 8 suggests that share of foreign ownership of the banking system may partially explain the low level of bank loans provision in Moldova. Poor access to cheaper external financial resources and lack of access to more advanced banking management know-how certainly was an important factor in keeping real interest rates high.



However, low share of foreign banks ownership in domestic ones is only one part of the story. Indeed, despite recent arrivals of some foreign banks on the Moldovan banking sector, the interest rates have shown little reduction. The other part of the story is the low level of development of business culture, as many directors of local enterprises have a very poor understanding on what a business plan is and how is it elaborated and used to get a loan. Moldova was home to completely vicious practices of bank officers often writing business plans for the loan-takers. Banks themselves have had a poor diversification of risks. As result, the 2009 financial crisis has more than doubled the share of non-performing loans in total banks assets. Therefore, the banks themselves are presently short of resources for providing long-term loans. Despite rising thorny issues related to economic and fiscal justice and to moral hazard, it is clear that solving the node of accumulated non-performing loans in commercial banks is key to resuming a more sustainable economic growth in Moldova. Solving that node does not necessarily mean saving banks with public money – an idea difficult to accredit politically – but rather a clear time-schedule of sorting bad credits out with clear commitments from all parties involved and likely with some money from the part of the EU banks. Getting such inflows from the EU development banks is not as insurmountable as it seems, because the Moldovan banking system is presently definitely less troubled than those in other countries from the region. However the commercial banks should devote more time, resources and marketing imagination to win the public confidence, which is quite low presently. As our sociological survey shows, the balance of popular trust in commercial banks as of end 2009 was still rather negative: 32% of the public having trust in banks against 44% not having trust.

A key aspect for ensuring consolidation of the financial system and hence for providing economy necessary investment resources is for the National Bank of Moldova to educate through its policy more public trust in national currency. Despite the quite respectable age of the national currency (Moldovan Leu entered circulation in November 1993), the public has yet a very low level of trust in it. Fundamentally, this is proven by the high level of bank deposit dollarization (41.1% of total in 2008 and an outright 50% in 2009). On occasional basis, the low trust in currency provides the material for social nervousness when the Leu temporarily depreciates against dollar or euro. Because the currency is ultimately an attribute of state sovereignty, low trust in currency inevitably erodes trust in the government and state. Therefore, the recent adoption of direct inflation targeting by the NBM is a right step in the right direction, but, as shown above, this requires more complementary reforms to address structural imbalances and low competitiveness of the country.

Looking for a niche in the global economy

With a negligibly small share in the global output (0.018%) Moldova is a typical example of a very small economy lacking any means to influence the regional and global economic environment. At the same time, Moldova is an open economy deeply integrated into the global trade flows: its foreign trade equals about 110% of its GDP. Moldova is not anymore as trapped into the geographical concentration of its trade as it was in early transition; this holds for both exports and imports (Table 4). In fact, the current geographical distribution of the Moldovan trade is very close to the balance predicted based on the international trade gravity theory.

In long term, Moldova has also achieved a certain degree of products diversification, both for exports and imports (Table 5). The country departed from the traditional structure of exports dominated by low-value agricultural products, but presently its exports are dominated by textiles, more advanced in terms of labor payment but still not very advanced in terms of technology and marketed brands and derived revenues (most of the textile companies operating under the so-called *lohn*-agreements). However, the firm progress of some higher value exports (chemical products and plastics, metal articles, construction materials, machines and equipment) show that the country is finding also some more profitable niches on the international markets.

Table 4 Geographic structure of Moldova's foreign trade, % of total

	Exports		Imports	
	1997	2008	1997	2008
Russia	58.2	19.7	28.4	13.6
Ukraine	5.7	9.0	18.0	17.1
Other CIS	5.7	10.5	5.1	4.7
Romania	6.7	21.1	8.6	12.1
Germany	3.7	4.0	8.1	7.4
Italy	2.7	10.5	4.1	6.3
Other EU	8.1	15.9	17.5	17.2
US	6.7	0.9	3.5	1.9
Switzerland	0.2	2.5	1.1	0.6
China	0.0	0.2	0.1	6.6
Turkey	0.6	2.1	1.2	4.7
Other countries	1.7	3.6	4.2	7.8
Total	100	100	100	100

Source: NBS and EG calculations

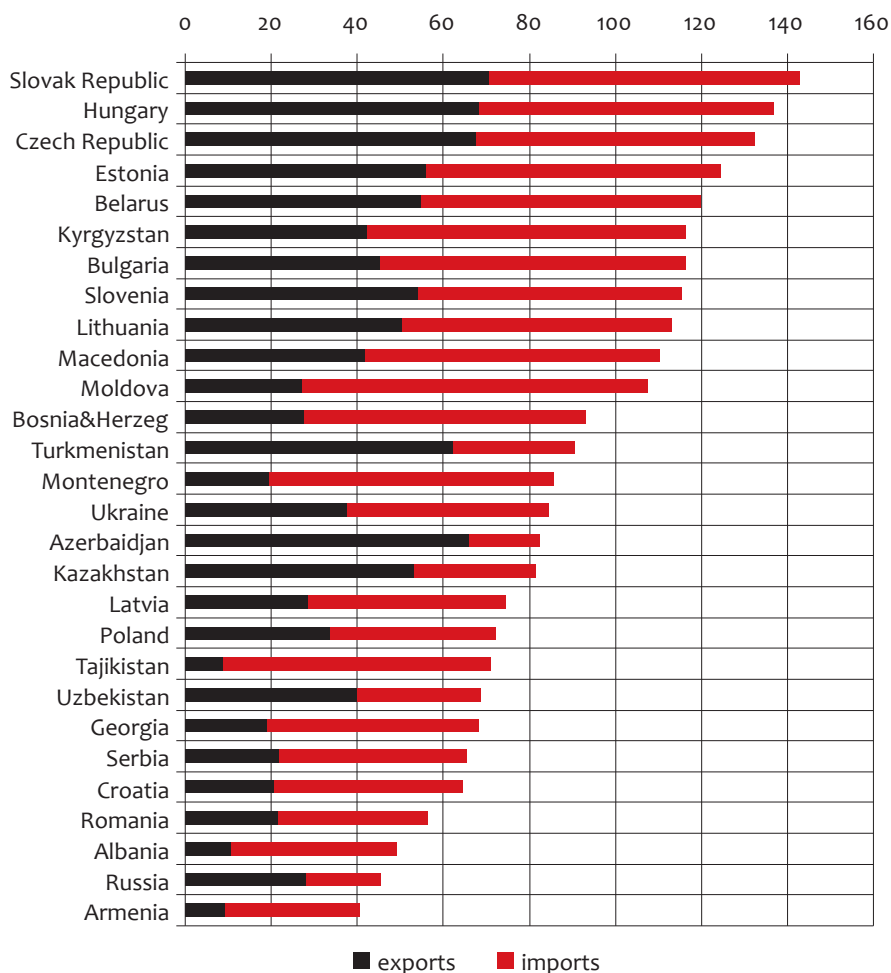
Nonetheless, with merchandise imports four times bigger than exports in 2008, and service imports matching exports, it is obvious that Moldova's trade integration into the global economy is utterly unbalanced; actually this is one of the most unbalanced trade structures in the group of transition countries (Chart 9). This is not an incidental issue, but rather a deeply-rooted economic trend persisting since 1997 and posing significant risks and limits for the country economic development.

Table 5 Product structure of Moldova's foreign trade, % of total

	Exports		Imports	
	1997	2008	1997	2008
Live animals and animal products	8.6	0.6	1.9	2.0
Vegetal products	8.6	13.2	3.2	3.4
Vegetal and animal oils and fats	1.0	4.0	0.4	0.4
Food, beverages, tobacco	54.8	19.6	7.5	7.0
Mineral products	0.4	4.0	35.3	23.0
Chemical products	1.5	2.1	9.6	8.5
Plastics, rubber and articles thereof	0.6	2.4	3.1	5.7
Leather, furs and products thereof	1.4	2.1	0.3	0.7
Wood and wood products, except furniture	0.1	0.3	1.7	1.8
Cellulose, paper, paperboard and articles thereof	0.4	1.1	4.1	2.4
Textiles and articles thereof	6.7	19.7	5.3	5.8
Footwear, hats, umbrellas and other similar products	0.7	3.0	0.3	0.6
Articles of stone, gypsum, cement, glass and other similar materials	1.4	3.3	3.9	2.8
Common metals and articles thereof	1.0	7.5	4.4	7.6
Machines and device; electric equipment	5.2	10.5	12.9	15.6
Transport means and materials	5.9	1.0	3.0	8.0
Optic, photographic, medical tools and devices; watches; other similar products	0.4	1.8	1.7	1.5
Other goods	1.4	3.8	1.3	3.0
Total, million USD	874.1	1591.2	1171.2	4898.8

Source: NBS and EG calculations;

Chart 9 Merchandise exports and imports, % of GDP

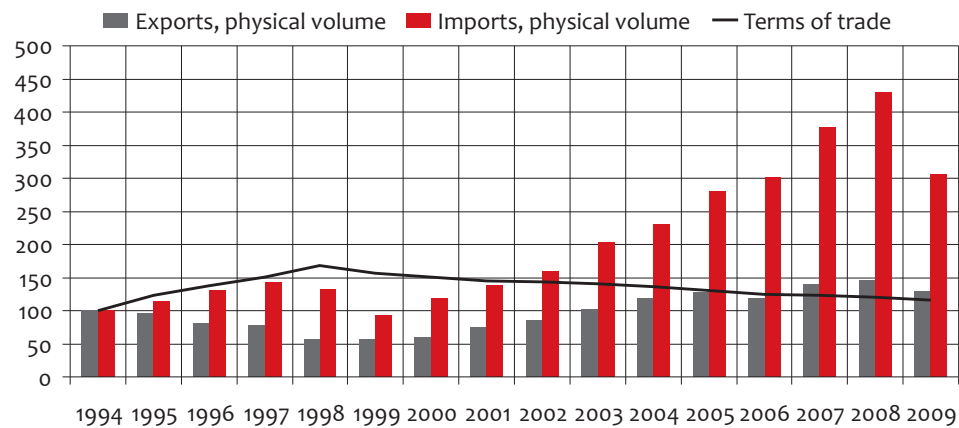


Source: EG calculations based on EBRD;

There are two underlying causes behind this negative trend. The most oft-cited is that since early transition Moldova experienced a constant worsening of its terms of trade (Chart 10), meaning that the country's exports are becoming less valuable in comparison with the imports by price. After a 70% growth in 1994-1998, the Moldova's terms of trade worsened slowly but steadily. Even more, according to our estimates, Moldova's terms of trade have fared worst by transition countries standards.

But the second reason – accelerated growth of the physical volumes of imports and sluggish growth of exports volumes – has been more important. For a country whose imports exceed 80% of the GDP and a significant part of these are vitally important intermediary imports (electric power, fuel, gas, industrial equipment) or final consumption goods (food), Moldovan exports appear too small as total quantity and too cheap in order to provide the necessary currency inflows to pay for the imports that have grown at an outstanding pace. No surprise, the current account has been under constant pressures, going from -8.1% of GDP in 2005 to -16.7% in 2008. The economic recession in 2009 alleviated the tensions which are expected to remain subdued in the mid-term.

Chart 10 Evolution of Moldova's terms of trade, exports and imports physical volumes, index previous year=100%



Source: NBS and EG calculations;

As a net assessment, aside Ukraine and Georgia, no other transition country has suffered such a dramatic economic decline and such a slow recovery as Moldova. Against most of the transition countries, Moldova has made very little economic progress since USSR demise. As much as policy is concerned, the string of Moldovan governments lacked a strategic and thorough approach to Moldovan development and the vision how to use the country's endowment. Economic stagnation is reflected in the poor quality of infrastructure, meager living standards and intense emigration of people from both rural and urban settlements. Broadly, Moldova was not able to make use of its natural endowment and human resources and to overcome its structural weaknesses. The most significant drawback is Moldova's inability to get rid of its patchy regulatory environment and to attract and retain foreign (as well as domestic) investments. The economic growth achieved between 2000 and 2008 ended when its main engine – migrants' remittances – contracted. Financial markets are still feeble and unable to provide the much necessary investments at a reasonable cost. With its exports growing rather slowly and imports mostly concentrated in non-substitutable items, the country has also suffered from a rapidly worsening terms of trade. The bottom line conclusion is that the true economic modernization of the country is yet to be achieved and unfortunately, if it proceeds at recent pace, this task will span over many electoral cycles if not decades.

Domestic politics

3. Domestic policy: cyclical motion

This chapter is dedicated to a strategic analysis of the domestic political environment in Moldova. It starts with an exercise of deciphering the main dividing and uniting lines within the Moldova society. Further on it is shown how this complex identity background corroborated with generalized public's dissatisfaction in politics to explode after the elections of April 5, 2009. The very low living standards provide the fertile terrain for accumulation of social discontent. At the end of the chapter it explained how low political culture and political apathy combined with power vertical resulting in the rule of law being replaced by the rule of party after 2001 and what implications that has for the state.

...“A house divided against itself shall not stand”...

The Republic of Moldova, as well as its territory, has had a very tumultuous evolution; hence its complex historical, cultural, and identity background. If employed rationally, this complexity can serve as a source of country's development and modernization; if it is used to ill ends, it can hamper country's development and social cohesion.

Obviously, in such a fragile and immature society as Moldova's it should not come as a surprise that this complex nature provides fertile ground for dividing lines periodically re-emerge in Moldovan social realities and public discourse. These dividing lines are quite diverse in nature and come across ethnical, linguistic, religious venues; they also transcend into domestic and foreign policy preferences. The roughly equal division of the parliamentary seats between the Alliance for European Integration and Party of Communists and protracted stalemate to elect the country president are an eloquent example of this. The table 6 below shows the overall picture in a schematic and generalized manner, but it can serve as a convenient tool for figuring out where the most of dividing lines are positioned. When the gaps brought into life by exploitation or political manipulation of the dividing lines are getting too wide the formulation and articulation of the national consensus is hardly possible. Conversely, the attempts to force “identity solutions” or “national ideas” concocted by some quarters of political elites upon opposing groups, are often met, sooner or later, by harsh political backlashes and even extreme political swings in opposing direction.

It is astonishing how persistent these lines have been and how easily they have fuelled social animosities throughout the last decade or so. Furthermore, these dividing lines have been often deftly exploited by various quarters of the political elites for shifting public attention from core and universal problems to sector or group ones. However, this is hardly surprising when one examines closely the factors that influence public opinion. Different parts of Moldovan society have increasingly opposite domestic and foreign policy leanings; they watch absolutely different TV stations, read different newspapers and even being Christian Orthodox they go to different Metropolitan Churches. Certainly, this is not meant to say that Moldova's citizens should watch the same TV or read the same newspapers. The problem is that there is too little communication between main society's groups who often live in distinctively different realities, while respective media and churches do regretfully little to narrow those dividing lines. At the same time, although it is hard to gauge, growing share of Moldovan citizens relies on having second or even third

citizenship (Romanian, Russian, Ukrainian, Bulgarian, etc.). It becomes increasingly hard to see what keeps these people together. What is the glue that should hold these diverging parts together? Is Moldovan citizenry an historic accident after all?

Table 6 Main dividing lines of different backgrounds, schematic overview

Main spoken language	Ethnicity (self-identification)	Domestic policy leaning (Parliamentary parties)	External policy leanings	Church	Mostly watched and trusted media
Romanian/ Moldovan	Romanian	Liberal Party (PL), Liberal Democrat Party (PLDM), less Alliance for Our Moldova (AMN)	Pro-EU, pro-NATO, often pro-re-unification with Romania	Bessarabia Metropolitan Church, Romanian patriarchate	Romanian and local
	Moldovan	Party of Communists (PCRM), Democrat Party (PDM), AMN, PLDM	Varying and combining: Pro-EU, balanced policy and close ties with Russia; Anti-NATO, anti-re-unification. Sensitive to any “Romanian incursion” that might, in reality or imagination, jeopardize Moldovan statehood. Sometimes nostalgic about Soviet Union.	Both Moldova (service in Romanian language) and Bessarabia Metropolitan Churches	Local, Russian and Romanian
Russian	Russian, Ukrainian, Gagauz, Jewish, Bulgarian, etc.	PDM, PCRM, much less AMN and PLDM	Varying: openly pro-Russian, moderate pro-Russian and pro-Ukrainian leanings, moderately and openly pro-EU, slightly more nostalgic about Soviet Union	Moldova Metropolitan church, Moscow patriarchate (except Jewish community);	Russian, local

Source: EG;

Certainly such a situation is not something especially new for new states formed in the wake of demise of “empires”. Indeed, many post-Soviet and Balkan states have had to deal with blurred identities and historical legacies in the process of consolidating their statehoods. However, most of these nations had a sort of internal “ideological” anchor, a feeling of “us” as opposed to “them”; and even if this principle has not been shared by all of the citizens of newly formed states, at least those societies managed to forge a core segment in them. In its turn, this core was able to put forward and promote a common “national” vision and idea of what the new state should look like and to what it should aspire.

Furthermore, these new states usually did not have clear-cut components that could be attributed or attached to bigger geopolitical (and ethnically akin) entities and with which considerable parts of society could associate themselves. In other words, many countries did not have external “geopolitical” anchors powerful and attractive enough to tear that country apart.

In this sense, Moldova appears to have gone full cycle. After almost two decades of independence the pro-active core citizenry able to formulate and promote “national and civic” vision is nowhere to find. Instead, botched efforts to “forge” *homo moldavicus*, as an ethnically separate Moldovan identity opposed to the Romanian one, at the expense of civic identity have apparently compromised the self-identification and statehood altogether. The principle “ethnic identity first, civic identity second” has undermined the natural course of formation of the civil core needed for articulation and promotion of vision and national ideas on which the statehood foundations are to be laid. In other words, Moldovan citizens identify themselves along the ethnical lines (alas,

dividing them) and only after that, if ever, by civic ones (that unite them). A well-documented analysis of the classical dichotomy of the civic versus ethnical identity can be found in Gabriel Andreescu's "Nations and Minorities", which is summarised in the Table 7 below.

Table 7 Civic-based versus ethnic based national legitimization

Civic-based	Ethnic-based
by law	by common roots (blood)
by elections	by inheritance (nepotism)
rational choice	emotional choice
unity by consensus	unity by status
democratic pluralism	ethnic majority rule
freedom	brotherhood
persons makes nation	nation makes person

Source: Gabriel Andreescu's "Nations and Minorities", Polirom, 2004;

To make situation even more complex, in this state- and nation-building process Moldova has had to face off two powerful geopolitical actors (one more actor can be added further on), akin ethnically to relatively important shares of population and whose part Republic of Moldova happened to be in different periods of past: Romania and Russia. Although both states declaratively recognize and support Moldova's independence, lingering fears and doubts about the sincerity of their intentions endure as well as do vociferous social groups aspiring to (re)unification in one form or another. Besides that historical memories, cultural and blood bonds maintain attractiveness of the respective "metropolis"; quite naturally, this attractiveness becomes more conspicuous in the process of successive policy failures by Moldovan domestic political class. So long as Moldovan state will not be able to deliver on its basic obligations of personal economic and physical security, political and human rights' protection, to facilitate and provide venue for political expression and participation aimed at consensus-seeking, and to respond to fundamental aspirations of its people so long the evolutionary forging of the "ideological" and "geopolitical" core will elude to occur.

Political participation: the story of disillusioned stakeholder...

One of the major frailties of Moldovan state is its continuous inability to meet expectations of its people and to ensure that they have their say in the political process. Most of the sociological surveys¹ reveal unrelenting public dissatisfaction with the path followed by the country and the way it is governed (Chart 11).

Besides brief episode in the beginning of 2005, the number of those who thought that country was moving in the right direction never exceeded that of citizens thinking the country was heading in wrong direction.

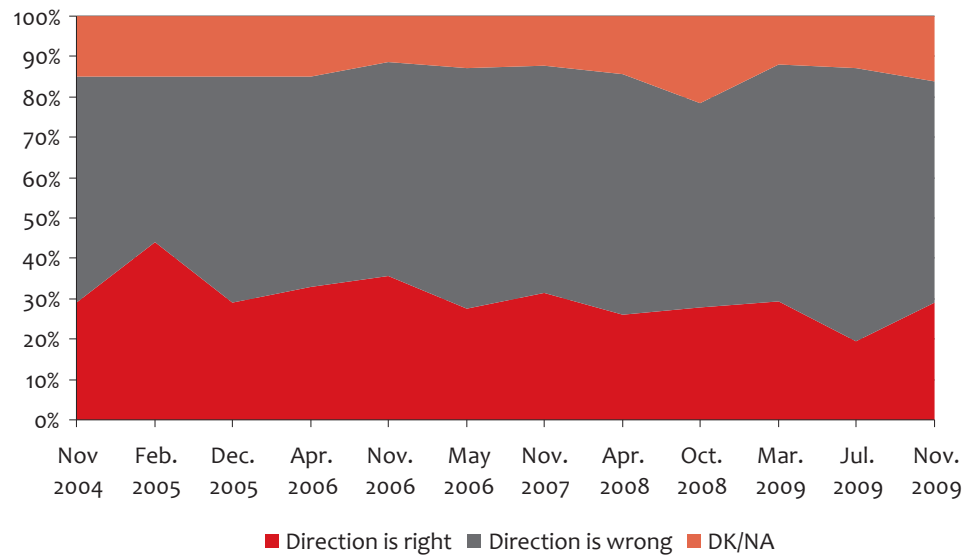
At the same time people have had the feeling that their views are not taken into account and they effectively lack any say over the policy issues both on local and national levels (Chart 12). Moreover, less than one quarter of Moldovans believe the country is governed along with people's will, while more than half believe exactly the opposite². Such a situation may lead either to political apathy (lack of interest towards policy and lower participation in political process) or to social unrest and street protests³.

¹ This trend is also supported by data from "Moldova National Studies" under IRI auspices as well as survey "Moldova 2009: state of the country and of the people", conducted as part of 2009 State of the Country Report Project.

² Institute for Public Policy, "Barometer of Public Opinion", November 2009;

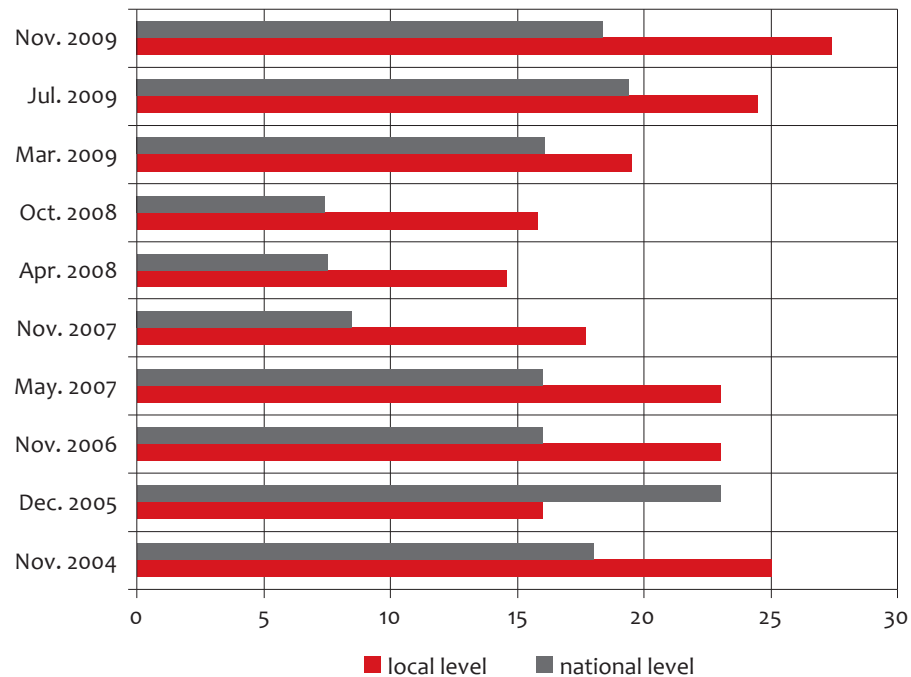
³ Worrisome trends became easy to observe much earlier, see also *State of The Country Report 2007*, Expert-Grup, 2008.

Chart 11 Distribution of answers to the question “Do you think that our country is moving in right or wrong direction?”



Source: Barometer of Public Opinion, IPP.

Chart 12 Share of citizens who think they can influence to a significant degree important decisions taken at the national and local level



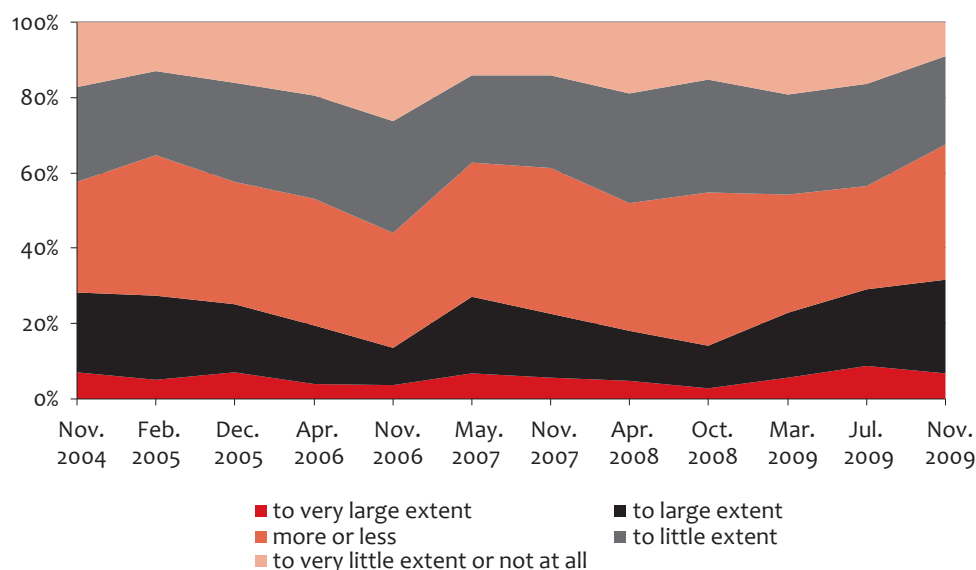
Source: Barometer of Public Opinion, IPP.

More or less both of those could be observed in Moldova throughout recent years. On average, less than quarter of Moldovans expressed substantial interest in domestic politics up to parliamentary elections of 2009¹ (Chart 13). At the same time, the voter turnout was in continuous decline since parliamentary elections of 27 February 1994 to 5 April 2009 from 79.31% to 57.55%, only to budge a little bit upwards in July 2009 elections to 58.77%. Moreover, both IPP and IRI surveys show subdued numbers of those who believe elections in Moldova are free and fair. The latest BPO survey shows roughly equal shares of those who believe and who do not believe elections are free and fair: 42.3% vs. 42%, respectively². Rubbing salt in a wound, the trust towards political parties which are supposed to be main bearers of people interest in public politics was at historical lows in the recent years: only around 15% of Moldovans did trust political parties in 2007-2008, while the parties were the least trusted institution in Moldova in that period³.

In its turn, social protests in the period preceding April elections of 2009 were generally focused on some very specific and sensitive issues related to certain broader or narrower social groups with topics ranging from history and language issues, to status of Transnistrian region and business patents holders. In a way they were not bearing systemic character or representing fundamental challenges to incumbent government.

Thus, an extremely divided society “enriched” with such ingredients as generalized public’s dissatisfaction in politics and suppressed opposition groups, flavoured with pre-electoral manipulations, aggressive electoral campaigning, unfolding economic meltdown and alleged electoral fraud, was ready to explode. And so it did. The post-election events in April 2009 shattered all the illusions regarding state of Moldovan democracy and governance; it also showed how fragile and polarized Moldovan society is.

Chart 13 Distribution of answers to the question: “How much are you interested in politics?”



Source: *Barometer of Public Opinion*, IPP.

¹ See also “Moldova National Study, November 10-25, 2008”, IRI.

² Institute for Public Policy, “Barometer of Public Opinion”, November 2009;

³ Institute for Public Policy, “Barometer of Public Opinion”, November 2009;

The street protests, accompanied by marauding of two main state buildings¹, are not exactly the attributes of the normal democratic process. Nonetheless, there are some positives to be taken anyway. The April events appeared as a systemic challenge to the incumbent power by those dissatisfied with political process, whose political grievances were suppressed during last couple of years. At the same time it served as a rude awakening for “contemplating” majority that self-detachment and apathy are not necessarily the way to improve their lives: Moldova was back in nineties grasping air for solutions of the same existential issues.

The period that followed the April 2009 events and especially the period preceding repeated elections in July of 2009 showed increased public interest in politics at the background of ever more divisive electoral campaign², higher voter turnout and even higher level of trust in political parties as institutions. In a sense this reveals both the fact that acrimonious electoral campaign and transfer of power rekindled dividing spirits in Moldovan society, but also a new hope. The fact that power is held by the alliance of parties, and is not a show run by a single party, is both a risk and sign of positive changes requiring ability to maintain dialog and communication between partners with different and even opposite views on a series of the issues.

In order to build on the momentum, and there are signs that it may start fading quite soon, the Alliance needs an explicit set of “common” priorities to be embedded into agenda and to be implemented. At the same time, the renewed hope for more participation should not be wasted. The participatory process encompassing business associations, non-governmental organizations, academia, etc., should be filled with substance, while people in general need to have the feeling of “ownership” in the country’s development. Failure to deliver it again main mean the country could enter just another cycle.

Unsuccessful welfare state

Welfare policy is not a secondary issue for the purpose of our analysis. Moldova is a poor country and the use of public resources for achieving social welfare and improving living standards of the population tells a lot about the country’s domestic politics. More over, there are a number of welfare-related arduous issues that influence the current policy; and they will do even more so in the future.

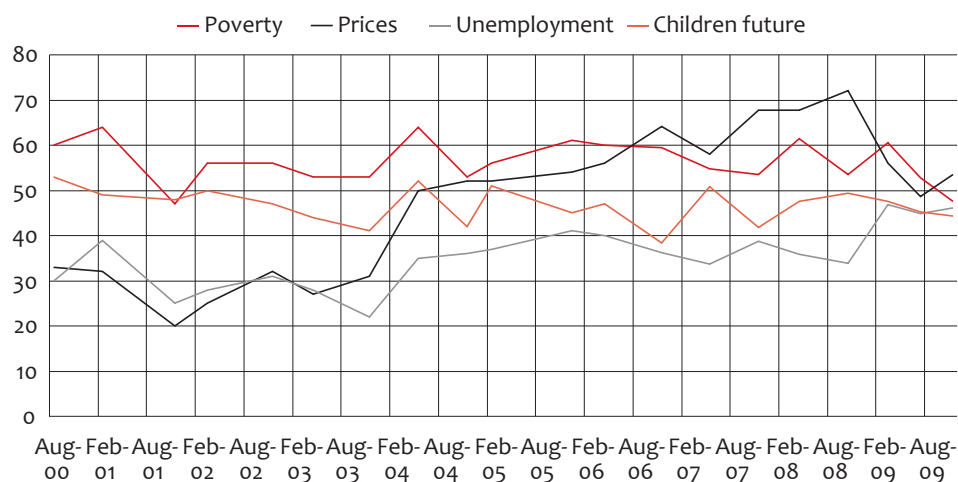
With a very weak private entrepreneurship and a vast rural and graying population, Moldovan society was poised to manifest leftist political preferences and to exaggerate the paternalist expectations from the part of “the state” in the last two decades. Responding to this social mood, the Constitution provides that Moldovan economy is a market-based economy with social orientation. It also provides for many other social guarantees in the area of education, health and labor. With all these provisions incorporated in the supreme law of the state, one would expect Moldova at least to converge towards if not to be a welfare state. However, policies adopted in Moldova responded little to the real needs of the country. As result, people’s welfare very little changed since inception of the economic transition.

Surveys conducted in Moldova in the last decade or so reveal a constellation of issues that Moldovan population confronts with. Some of these problems seem to have been addressed and are therefore declining in the gamut of the people preoccupations; for instance, while in August 2000 crimes level was a concern for 28% of the country population, it was so only for 10% in November 2009³. Similar declining trends can be observed for a number of other social concerns, such as famine, war, natural calamities, and diseases. But a few of existential issues have permanently frightened the Moldovan citizenry: poverty, prices, unemployment and children future (Chart 14). Some of them have only become more prominent lately, such as prices and unemployment.

¹ The competent investigation is yet to shed light on the April 2009 protests and preceding alleged (pre)electoral fraud;

² The incumbent party excelled with its “Protect our Motherland!” campaign, which actually backfired against the Party of Communists;

³ Institute for Public Policy, *Barometers of the Social Opinion*, various issues;

Chart 14 Most prominent answers to the question “What problems are you mostly afraid of?”

Source: BoPs;

Table 8 Distribution of the answers to the question “Which answer better describes your household’s situation in respect with the following public and housing services?”

	I do not have access to this service	I have problems with access to this service	Most of the time I am satisfied of the access to this service	I have full access to this service	NA
Running water	40.6	6.4	7.4	43.0	2.6
Hot water	61.4	7.9	5.2	22.1	3.3
Sewage system	55.3	6.4	6.2	29.0	3.1
Gas	46.7	4.7	7.2	40.1	1.4
Roads	9.2	21.4	19.4	47.5	2.5
Electric energy	1.7	7.3	13.5	76.4	1.1
Thermal energy	58.4	5.0	7.7	23.8	5.2

Note: due to rounding off the sum per rows may not necessarily total up to 100%;

Sources: IMAS;

Table 9 Distribution of the answers to the question “Which of the following technologies are present in your household?”

	I do not have access to this service	I have problems with access to this service	Most of the time I am satisfied of the access to this service	I have full access to this service	NA
Landline telephone	19.2	2.2	10.4	67.4	0.8
Mobile telephone	38.0	3.8	6.1	49.2	3.0
Computer	62.5	5.8	3.8	23.2	4.7
Internet	65.9	6.9	3.4	19.0	4.8
TV set	6.9	7.0	10.4	74.5	1.2
Cable TV	19.2	2.2	10.4	67.4	0.8

Note: due to rounding off the sum per rows may not necessarily total up to 100%;

Sources: IMAS;

The sociological survey conducted for the purpose of this report has also underlined the low living standards persisting in Moldova (Table 8 and Table 9). It is really disappointing to notice that in the early 21st century most of the Moldovans still live like in early 20th century, i.e. without basic housing services, poor road connections, with problems in accessing electric power grid and less than negligible penetration of the digital technologies.

As roughly a half of the Moldovan citizens are still afraid of poverty, prices, uncertain future for their children, and unemployment, and more than half of them is missing access to modern day services and technologies, it is clear that fundamental needs of the population are far from being fulfilled yet. This is particularly an issue for the country-side. With migration option easily available and villagers' children receiving an education comparable to the urban ones allowing them to pursue urban-based careers, it is clear that quite many Moldovan rural settlements are doomed. Addressing these core issues has to be present as the overarching goal on the agenda of any benevolent government in Moldova. Otherwise, such a destitute and ignorant population could be (and in fact was) an easy electoral prey for any unscrupulous domestic political party or foreign encroachment.

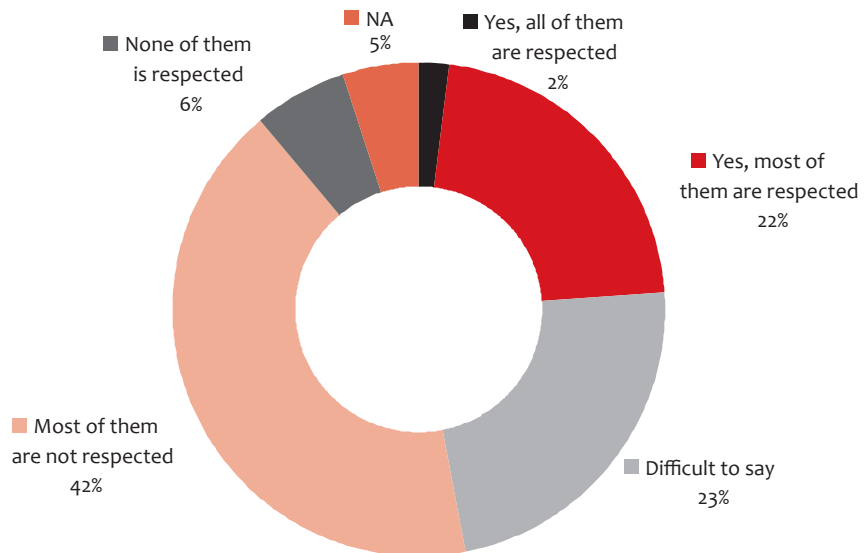
Between the rule of law and the rule of party

Since its independence back in 1991 Moldova has tried countless reforms with the declared purpose of consolidating the democratic institutions and rule of law. Moldova has also adhered to many international treaties requiring the government actively enforce the rule of law, democratic values, human dignity, human rights and liberties. Despite this, Moldova remains an outstanding laggard in all important international ratings assessing the progress of the post-communist countries in practical implementation of these standards. Quite a relevant indicator in this regard is the number of complaints addressed to the European Court for Human Rights against Moldova that constantly increased in the last decade. The 3350 applications filed in against Moldova pending before a judicial formation on December 31, 2009, made the ECHR label Moldova as a “high case-count state”¹. With 3.70 cases allocated for trial per 10000 country inhabitants, Moldova is “outperformed” only by Georgia (5.03), Liechtenstein (3.92) and Montenegro (4.30).

But more than any international rating and quantitative indicator, public perceptions regarding the functioning of the democratic institutions and the rule of law are those that should matter the most for a meaningful government. Suggestively, about 6% of the country citizens perceive that none of their rights is adequately protected in the Moldovan society, while other 42% of the citizens believe that most of their rights are not respected; for about one quarter of the Moldovans “it is difficult to say” unequivocally whether or not their rights are adequately respected (Chart 15). Answers to the question “in case that your legitimate rights would be violated, do you believe that the justice in our country would protect you” are similarly distributed (Chart 16), serving as a key testimony for the low level of public trust in Moldovan justice system.

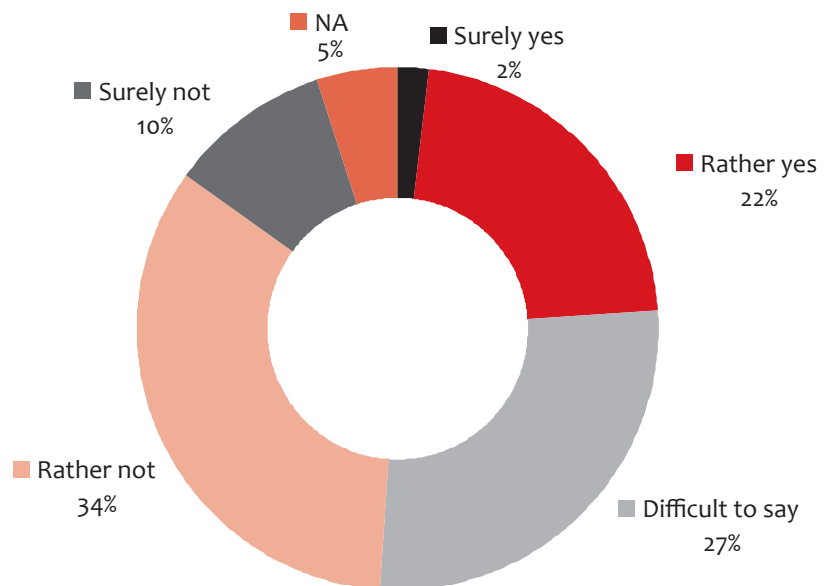
¹ European Court for Human Rights, *Analysis of Statistics 2009*, report downloaded at http://www.echr.coe.int/NR/ronlyres/89A5AF7D-83D4-4A7B-8B91-6F4FA11AE51D/o/Analysis_of_statistics2009.pdf

Chart 15 Distribution of the answers to the question “Do you generally believe that your rights are respected in the Moldovan society?”



Source: IMAS;

Chart 16 Distribution of answers to the question “In case that your legitimate rights would be violated, do you believe that the justice in our country would protect you?”



Source: IMAS;

More than anything else, the political year 2009 could serve as the litmus test for the status of the “rule of law” in Moldova. In 2009 parliamentary elections were held on April 5 amid widespread allegations of the unfair campaign and rigged outcomes. The parliament was dissolved after two failed rounds to elect the country’s new president and early elections took place on July 29. Some international organizations, including the OSCE, claimed that the parliamentary elections were held

with no major electoral fraud¹, but these claims refer mostly to the technical part of the elections, i.e. to the voting itself. The OSCE statement acknowledged that numerous infringements of the voters' rights took place through use of administrative tools, subtle or overt intimidation of mass-media and opposition parties, and heavy involvement of the state security apparatus in favor of the Party of Communists. A grand coalition of domestic observers ascertained many frauds and irregularities before and during both April and July parliamentary elections and outright declared that both elections were not correct and only partially free².

Following the April 5 elections, peaceful demonstrations against the electoral frauds commenced on April 6. They continued on April 7, but this time some parts from within demonstrators turned violent and vandalized the Parliament and Presidency building. The events were qualified by the then-ruling Party of Communists as Romania-inspired attempt of coup d'état. While there were clear evidences that violence against police and looting of the state buildings ultimately had an organized character, it is not yet clear who the organizers and executors were. Inadequate protection of the public buildings and inadequate handling of violence by the security forces was followed by violent response from the part of the police and other forces on 7 and 8 of April 2009. The way how youth and adults have been haphazardly arrested (minors seized in schools, people arrested on the streets, during nights, in public transport, by people wearing civil clothes, with no explanation of the arrest reasons, remote places chosen for their detention) shows that security forces acted as a repression apparatus and not as a law enforcement one. More than that, the reprimand character of the security forces surfaced in the way how arrested people have been treated in detention (with use of tortures, isolation, psychological violence, and reported cases of rape). Many apprehended persons had no access to lawyers, were denied the right of communicating with their relatives and were forced to self-denounce. Most of them were penalized with administrative arrests (for up to 10, 20 or 30 days), but a significant part of the trials were held directly in the police offices with little respect for a fair trial procedures. The latter was culminating malpractice very much resembling those from the Stalinist era.

There are many open questions related to the April 2009 political violence and there are also many conclusions that can be drawn. We believe though that such issues as who first threw the stones from the crowds, who were the people in black clothes commanding the mob, who hoisted the foreign flags on the Parliament and Presidency building, while important for those conducting public and legal inquiry, are nonetheless secondary for our analysis. Strategic analysis on the events that happened on April 7 and afterwards leads to a number of unpleasant conclusions.

Security system in Moldova is fundamentally flawed, and this refers to all its institutional components. The basis of the system was designed in the Soviet era and it essentially inherited features of a political police. It is no surprise that only 3% of the people in Moldova feel that the security of their own and their family is adequately protected, while 23% believe that security is to a certain extent protected³. On the other hand, 24% cannot assess the status of their own and their family security, 35% believe that security is rather not protected, while 9% feel entirely insecure⁴. These perceptions are not incidental, as in the period 2001-2009 the security system in Moldova was basically used to protect Communists Party interests rather than providing for the state and society security. During and after April 2009 protests the security system has evidently acted coordinately to spread social fear and polarize the society using such tools as: closing down websites; using

¹ Organization for Security and Cooperation in Europe, Office for Democratic Institutions and human Rights, "Republic of Moldova Parliamentary Elections of April 5, 2009: Election Observation Mission Final Report", report available at http://www.osce.org/documents/odi-hr/2009/06/38185_en.pdf;

² Coalition 2009: Civic coalition for free and fair elections, Declarations and Press-statements, available at <http://www.alegeliber.md/index.php/ro/declaratii-comunicate>;

³ Results of the Sociological survey "Moldova 2009: state of the country and of the people" conducted as part of the State of the Country Report project.

⁴ Idem;

telephone surveillance; widespread use of state control bodies as a oppressive measure against private entities and NGOs, interdiction for international mass-media representatives to enter the country; intimidation of journalists; heavy brainwash through communists' affiliated TV and radio outlets; politically-biased declarations and media statements by the general prosecutor, minister of interior and head of information and security service; deporting Romanian ambassador and a minister-councilor; introducing visa regime for the Romanian citizens for the allegedly Romania-inspired coup d'état. The show directors undoubtedly got their inspiration from the Orwellian novels.

The normal way for the Moldovan police is to act as a repressive rather than law-enforcement agency. Violence and torture was not an accidental way of police behaving against youth and adults arrested in connection with the April 7 events. Violence and torture, often in unimaginably brutal forms, was always used by the Moldovan police as a normal way of obtaining evidence¹. Specialists are citing different causes of the pervasive use of torture of the people held in police custody, including political tolerance from the part of the Government, President and Parliament. We believe that the situation is much worse, maltreatment being an integral part of the institutional culture within the Moldovan police. Temptation is often high to blame the police violence as a habit inherited from the Soviet militia. However, in the Soviet times the militia was much less cruel than Moldovan police. Even more worrying, most of the publicly known cases of torture involve young policemen, which did not serve in Soviet times. Another suggestive fact is that violent behavior from the part of the police against apprehended people was explained by “psychological pressures”, which basically means that police is not adequately trained to perform its duties which by default involves withstanding constant psychological pressure. What is particularly worrying is that during April days not a single officer from the police denounced the illegalities committed. Such a corporate solidarity is particularly upsetting, as it basically means that there is a culture of oppression and a sense of impunity inside the system.

Political independence and public accountability of the judicial and prosecution bodies were completely undermined after 2001. The Party of Communists and its political cronies have been very successful in saddling the judicial and prosecution bodies and using the justice system for own purposes. The most clear evidence on this is that prosecutors immediately followed the April 15, 2009 request of the then-president Vladimir Voronin to initiate a total amnesty of people held in custody in connection with April 7 events, even though the country president was not constitutionally entitled to provide such a universal amnesty. There is a widespread public perception in Moldova that judges and prosecutors are corrupt. Decisions of the judges are generally formulaic and little understood by the parties. While the government presently asserts that there is no political influence on the judicial system², it is hard to believe that people that got accustomed to serve political interests rather than the law would immediately start enforcing the law indiscriminately and in a fair manner.

Key democratic institutions in Moldova are far from providing a true democratic environment for the political life. Moldova has been under constant monitoring of the Council of Europe since 1995 and adopted many laws but materialized very little practical progress³. Electoral legislation (including the D'Hondt principle in counting seats and interdiction of electoral coalitions) contains severe restrictions affecting political life. Lack of a meaningful voters' register is the key obstacle that would permanently provide terrain for suspicions regarding rigged elections. Many public institutions, such as Central Electoral Commission and Audiovisual Coordinating Council, in 2001-2009 were reportedly permeated with interests of the Communists Party and it is not yet clear

¹ Promo-Lex, “Human Rights and Democratic Institutions in the Post-Election Period in Moldova, April 6 - July 1, 2009”, Chisinau, 2009;

² Minister of Justice of the Republic of Moldova, Mr. Alexandru Tanase, quoted by the “Timpul” magazine in the article “Justice: reformed and purified”, February 8, 2010;

³ Parliamentary Assembly of the Council of Europe, “The functioning of democratic institutions in Moldova”, doc.11878, April 28, 2009;

how they are operating presently. Public National Broadcasting Company Teleradio-Moldova transformed in the Party of Communists PR outlet and greatly manipulated the electoral behavior of the rural voters.

Last but not least, ***Soviet-time habits of “social alignment” and “political discipline” are still very influential in the Moldovan collective memory and behavior.*** Exponents of such attitudes do not need “rule of law” but rather “rule of party”. During the 2009 electoral campaigns staffs of the state-owned companies were mobilized to participate at meetings with the PCRM and “to make the right vote”; trade-unions were calling upon their members to cast their vote for the PCRM-enacted “stability and civil dignity”; social assistants were carrying PCRM political messages together with free-of-charge medicines and food.

All these shortcomings are the outcome of the unfinished political reforms during the early transition which in most of the cases were exacerbated by the Party of Communists power vertical that was carefully built after its ascension to power in 2001. The political system in Moldova evolved from a parliamentary republic in a de facto authoritarian regime. However, the seeds of this perverse political system allowing one party to parasite an entire state fell on the fertile soil provided by the very low political culture and political participation of the Moldovan society.

Foreign policy

4. Foreign policy: searching for the right balance...

As for a small country, open to the influence of the major external players, the clear understanding of the desirable country's goal is necessary, but not sufficient for Moldova. Therefore, the ability to navigate along the best possible path towards this goal is of paramount importance. In this sense, this chapter attempts to analyze the foreign policy of Moldova from the perspective of main constraints and determining factors of both domestic and foreign nature. Furthermore, this analysis looks at the context in which foreign policy decisions are to be made and what approaches to be taken to designing foreign policy decisions.

Foreign affairs...

As a small country situated on the wedge of two geopolitical centers of power Moldova is subject to a series of influences that have permeated the entire history of the country whether as a province of a bigger entity, or an independent state. These influences vary from economic and trade ties to linguistic and cultural connections. In the aftermath of Moldova's independence its foreign policy was strongly influenced by this domestic complexity of the relationships with major eastern and western neighbors as well as historical and geopolitical contexts. By far and large, throughout these years Moldovan political establishment was unable to formulate a balanced foreign policy aimed at effective promotion of the country's national interests (which for most of the period were not even clearly stated) and, thus, Moldovan policy was erratic or "multi-vector" to dizziness, at best¹.

At the same time along with various influences, Moldova can be seen as an area of geopolitical struggle between big geopolitical players. Roughly, the two major regional centers of power and poles of attraction have been so far: European Union and Russian Federation. On one hand, "identity" of European pole is strengthened for some politicians and social groups by Romania's membership in it and, thus, a prospect of re-unification in the European Family of peoples. The US, the most influential global player with significant interests in the post-Soviet periphery, is also supportive of Moldova's European orientation, which weighs heavily on the balance of power in the region. Nevertheless, US influence can be viewed as making EU option more complex, adding to it an Atlantist flavor. On other hand, Russia's "identity" is strengthened, again for some politicians and social groups, by persisting memories of relatively prosperous Soviet past. However, as it will be shown later, the public perceptions divide is not that clear-cut and the overall picture is quite blurred.

The intertwined ties – foreign policy constraints

As it was mentioned Moldova is a small country open and susceptible to a series of influences and constraints of various, albeit quite palpable, nature. This section of analysis attempts to outline these factors.

¹Curiously, the public opinion is also quite uniformly divided on the efficiency of Moldovan foreign policy, see "Moldova 2009: state of the country and of the people" survey conducted for Expert-Grup;

Development of Moldovan economy is strongly dependent on the ties with both European and Russian markets. Both players are major Moldovan trade partners: together they make up for $\frac{3}{4}$ of Moldovan exports and slightly over half of imports. Although the role of Russia, both for exports and imports shrank substantially in the last decade, this country still holds an important position for Moldovan exporters (Russia even advanced to the top position as export destination throughout 2009 on the country level). The wine embargo introduced by Russian authorities in March of 2006 had negative effects on the Moldovan economy and shattered country's wine sector. Generally, Russian market is vital for Moldovan agriculture, reflecting historical traditions, slow modernization of the sector and high competition on the EU market.

The level of Russian FDI entering Moldovan economy is quite low, reaching in the pre-crisis 2007 about 10% of the total stock. However, substantial part of the EU FDI (66.5% in 2007) comes from countries with more loose fiscal legislation and thus it is difficult to establish for sure the origins of that capital. At the same time, it is clear that significant FDI investment from the EU brings with it closer intra-industrial integration and thus includes Moldovan subcontractors in the multi-national chains. This process became more salient in the wake of the EU Eastern Enlargement.

The role of Russia is further strengthened by vulnerability of Moldova's energy security. For Moldova natural gas is the strategic energy resource (44% of total energy consumption as for 2007), especially for households. The prominence of natural gas as energy resource is not a vulnerability per se, however, the fact that there is no foreseeable alternative to Russian gas is one. Accidentally or not, the new Gazprom's gas price policy promoted towards the countries of the so-called "near abroad" coincided with new phase of Russian offensive in the former Soviet Union (fSU) in the aftermath of the Orange revolution in Ukraine, preceded by the failure of Kozak Memorandum in Moldova. Since then the prices for gas imported from Russia (technically it is Kazakh gas) to Moldova were raised more than four-fold from 80 USD per 1000 m³ in 2005 to 320 USD m³ in January 2010¹. Russia through its companies also holds significant position in gas transport infrastructure and power production (for instance, Cuciurgan plant in the break-away Transnistrian region which supplies power to right-bank Moldova). Furthermore, Russian Federation often tends to employ the energy levers as power tools to accomplish its geopolitical goals and does not shy away from cutting off the gas as Russo-Ukrainian winter spats showed. In this sense, Moldova's energy dependency is a major constraint on its foreign policy. Not surprisingly some important steps have been taken in order to diminish this vulnerability, such as accession to the Energy Community Treaty². However, significant positive outcomes are rather mid- and long-term in nature, therefore, in the short-term these vulnerabilities will endure to a substantial degree.

The Moldova's economic dependency on the EU and Russia does not stop here, however. For some years, labor migration and associated incomes drove Moldovan economy upwards by pushing up domestic demand and filling the coffers of the public budget. Before the global economic crisis peaked and its effects felt on the labor migration flows, Russia and the EU held an overwhelming position as the preferred destination for Moldovan labor migrants (Table 10).

Table 10 Moldovan migrants by destination, thousand persons, 2006-2008

	2006	2007	2008
EU	91.2	95.1	88.2
Russia	192.5	210.8	191.1
Other	26.5	29.7	30.5

Source: Labor Force Survey, NBS.

¹ Certainly, authors do not mean that Russia should subsidize the fSU economies with cheap gas; however the changes have often been dramatic and smacked of political revenge;

² This accession is conditional upon fulfillment of certain number of commitments by Moldova.

At the same time, the incomes of the migrants in the richer EU countries tend to be higher and thus remittances sent home tended to be on average higher than those sent from Russia. In 2007 the amount of remittances sent home by labor migrants reached a staggering number of 34.1% as share of Moldova's GDP. In 2008 when the global crisis impacts started kicking in, this level fell to 31.4%, nonetheless remittances have remained an important economic and social factor for Moldova.

Furthermore, there are several other aspects where both sides have leverage of different degrees.

First of all, it is Transnistrian conflict since its any palatable solution implies Russian good will to exert pressure over the self-proclaimed authorities of the region. At the same time, EU has only observer role in the negotiation process and has appeared so far very reluctant/unable to intervene strongly in the negotiation process. Furthermore, protracted political crisis in Moldova made practically untenable any efforts in this process in 2009. Nevertheless, through joint border mission EU helped securing eastern Moldovan-Ukrainian border. All in all, the institutional limbo in which is the respective region influences negatively capacity of Moldovan authorities to take foreign policy decisions for a hypothetical "re-united" Moldova.

Secondly, Russia has much more, if declining, media influence over the Moldovan population. Russian TV and newspapers are wide-spread in Moldova and enjoy high ratings. For instance, Russian "First Channel" re-aired in Moldova enjoys the status of the most watched TV channel along with the publicly owned Moldova 1; for 30% of Moldovans this Russian channel is the first choice for information and the second for another 25.4%.¹ In other words, many Moldovans see the world through Russia's eyes. Quite the opposite, the EU lacks such important media tools. The situation has been somewhat changing since linguistic legislation has become enforced and new important Romanian media players entered the Moldovan market, while some parts of governing Alliance are increasingly averse towards Russian media influence in the country.

Thirdly, the EU relatively excels with respect to so-called soft-power. The EU as a whole is already the biggest development donor for Moldova (over 60 mln. Euros under the National Action Plan in 2008), while several EU states with pro-active role in Moldova, such as Sweden, Great Britain, Poland, also add to the foreign aid development budget. Many EU states as well as other Western donors also provide programs that support local development, human rights, media, etc. Additionally, the US is extremely important player in this sphere which is also helpful for consolidation of the European or generally pro-Western Euroatlantist option. Furthermore, pro-European vision which rests on the success of the European integration process effectively dominates public discourse and intellectual debate in the country. In its turn, Russia cannot boast such success; its soft-power is toothless and is in the embryonic stage. In addition, Russia has not been able to provide its own vision that would not be a simple antithesis to the Western model and outlining its main vices.

Fourthly, the role of Russian Orthodox Church in Moldova should not be underestimated. The Church in general is viewed as the most trusted institution in Moldova: as much as 80% of Moldovan trust it according to some latest polls², while over 90% of Moldovan population are self-confessed Christian Orthodox³. There are two Metropolitan Orthodox Churches active in Moldova: the Church of Moldova (Moscow Patriarchate) and the Church of Bessarabia (Romanian Patriarchate). While it is hard to estimate the numbers of church-goers to any of the Churches, the Moldova's Metropolitan Church holds bigger sway, not least because the Bassarabian Church was

¹ Institute for Public Policy, "Barometer of Public Opinion", November 2009;

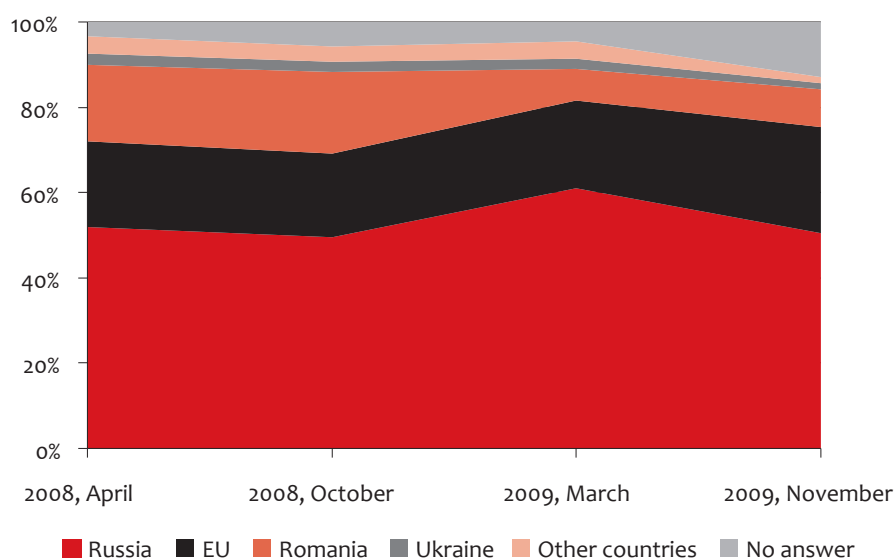
² Institute for Public Policy, "Barometer of Public Opinion", November 2009;

³ National Bureau of Statistics of Republic of Moldova, "Population Census 2004 data", available at <http://www.statistica.md/pageview.php?l=ro&idc=263&id=2208>;

officially registered quite recently. Some polls also show higher level of trust towards the former church vs. the latter: 76% vs. 62% of favorable views and 10% vs. 20% of unfavorable¹, respectively. The “church” issue is highly politicized with different parts of Moldovan political elite attending different churches². The pro-active roles of Russian and Romanian Orthodox Church leaderships can also be seen as a soft-power tool shaping state of mind of Moldovan people.

Given this myriad of factors and constraints it is little wonder that not only Moldovan foreign policy was quite unclear about its goals, but also public perceptions towards these main centers of power is extremely convoluted and blurred. Apparently, Moldovan population is both pro-European and pro-Russian at the same time. It sees Russia as the country that should be the main strategic partner for Moldova, much ahead of the EU, while at the same time majority of Moldovans would endorse accession of their country to the EU at the eventual referendum (see Chart 17 and Chart 18).

**Chart 17 Distribution of answers to the question
“What country should be the main strategic partner of the Republic of Moldova?”**



Source: Barometers of Public Opinion, IPP;

Adding another twist to this picture, more than half of poll’s respondents believe that Soviet Union’s demise had adverse impact on the Republic of Moldova, 40% wish re-unification of the “reformed” and “modernized” Union, and almost 44% of respondents would vote for “re-unification” at an eventual referendum with 16.3% being still undecided on the issue³. Furthermore, the most trusted foreign leaders for Moldovan population are members of Russian duumvirate: Vladimir Putin and Dmitry Medvedev⁴.

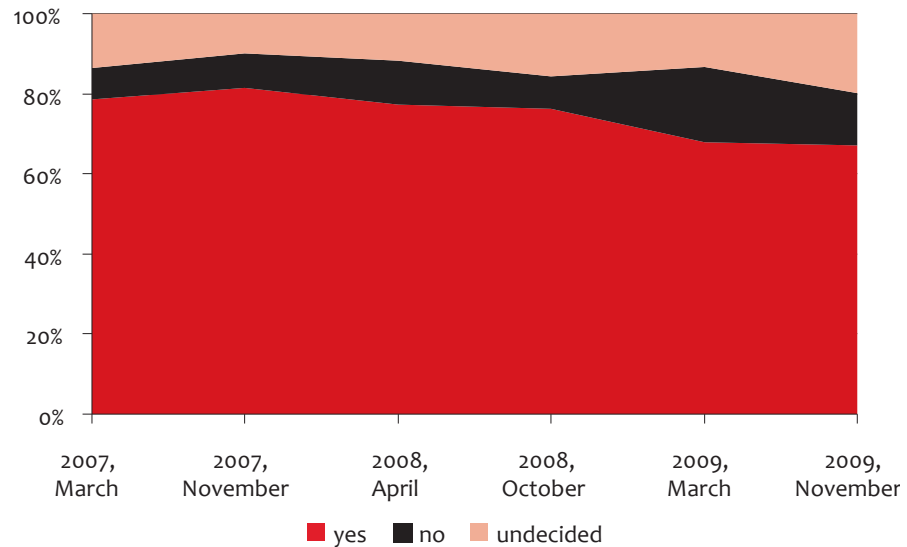
¹ International Republican Institute, “Moldova National Study”, Chisinau November 10-25, 2008;

² At the same time in 2007-08 the issue of the date of Christmas celebration as well as Christmas tree installation in the central square of Chisinau became a bone of contention between then-in-power Communists and liberal mayor of the capital. As much as theatrical it was also revealing to which extent the polarization of Moldovan society has gone.

³ Institute for Public Policy, “Barometer of Public Opinion”, November 2009;

⁴ Idem;

Chart 18 Distribution of answers to the question “If the referendum on Moldova’s EU accession were held next Sunday, would you vote for or against?”



Source: Barometer of Public Opinion, IPP.

The apparent enigma of such a double consciousness is perhaps better explained that Moldovans base their choices not on the spiritual or political values, but on material ones. In other words, they vote not with heart or even head, but with stomach. So Moldovans, on aggregate, are fine with both “Unions” irrespective of political and cultural values at the foundation of those. In this sense, Moldova is indeed a country at the crossroads, coy on which path to chose.

The fluid international landscapes...

The fluid and dynamic international context adds another variable to the equation determining Moldova’s foreign policy decisions. The strength of the constraints may be mollified by relatively favorable developments of global and regional scale, and, conversely, adverse developments can magnify these constraints impeding in this sense achievement of the foreign policy goals.

To make matters worse the uncertainties of international context has recently been quite conducive to magnifying constraints over the Moldovan foreign policy, especially with regards to European integration option. First and foremost, the situation of the main geopolitical actors with interest in the region has changed:

Weakened US involvement in the region

Basic elements: United States has been a main geopolitical actor in the post-communist region since the fall of the Berlin Wall. It played a key role in democratization, liberalization and “westernization” of this region as well as in establishing the regional security architecture as we know it now. US supported democratization and market reform in Moldova since its independence in 1991. The US has also tried to support the settlement of the Transnistrian conflict that would be consistent with principles of Moldova’s territorial integrity and sovereignty. The objectives of the US seem to be two-fold: (a) support Moldova’s democratization and modernization, possibly to the extent of fulfillment of Moldova’s euro-aspirations; (b) counter-balance Russian resurgence in the region and block Russian attempts aimed at bringing Moldova back to the Russian hold.

Current context: The recent geopolitical developments are not particularly favorable to high US involvement in the region in general. The United States has got bogged down in Iraq and Afghanistan (there are all the signs that President Obama will make Afghanistan “his” war), with the US military presence to be significantly increased in the latter¹. Furthermore, the United States is increasingly preoccupied with the nuclear threat posed by Iran. On both Afghanistan and Iran dossiers as well as on war on terror and new agreement on reduction and limitation of offensive nuclear arms to replace the Strategic Arms Reduction Treaty (START-1), the US needs Russia’s assistance either with security intelligence and logistics or political acquiescence for imposing stronger UN-endorsed sanctions, etc.². However, the relations between the two countries became extremely frosty in the late years Bush presidency. The election of Barack Obama as a new US President heralded also new approach in the US foreign policy towards global affairs. For Russo-American relations that meant a “reset” in an attempt to sooth the differences between two countries and to find common ground on a series of global and regional strategic issues.

However, it is not yet clear whether countries view this “reset” as a means to achieve the mutually shared goals. At least in East and South-East European context the relations between Russia and United States are as divergent as ever, while in current time setting Russia may well enjoy upper hand simply because US foreign policy priorities may lie elsewhere. In this sense lack of strong American reaction on the 2008 war between Russia and Georgia, a staunch American ally in the region, has been quite revealing; while the President Obama’s decision to call off deployment of the anti-missile defense systems in Poland and Czech Republic sent jitters throughout the region and prompted a group of regional leaders to write an open letter to American President warning of perils of appeasement towards increasingly assertive Russia.

European Union: still too heterogeneous on foreign policy matters

Basic elements: The EU has lately become a key factor in Moldova’s political, economic and social development. There has been important institutional progress in cooperation with Moldova, such as the EU-Moldova Action Plan, Autonomous Trade Preferences, EU Border Assistance Mission, Eastern Partnership initiative, etc. In 2010 Moldova is to start negotiating new Association Agreement and Free Trade agreement with the EU. The EU policy approach to Moldova is incremental. While Moldova stated clearly its desire to join the EU in the future, the EU has been staunchly reluctant to offer such a perspective. Moreover, as much as integration aspirations are concerned, the EU appears to view Moldova in a “regional perspective” (as part of its Eastern Partnership initiative), unwilling either single out it from the western CIS countries or include it in the “Western Balkans” package as Romania proposed. At the same time, the EU seems to be ready to assume an increasing role in promoting Moldova’s democratization and modernization and to counter-balance via soft-power policy tools the Russian resurgence.

Current context: The adoption of the Lisbon Treaty is meant to make European foreign policy more coherent and thus make the Union a stronger geopolitical player. However, the Lisbon Treaty may also mean growing role of bigger states, such as France and Germany, in the process of policy and decision-making³. At the same time, the more specific matters are yet to be settled more straight-forwardly in practice. In a sense, in the forthcoming period the EU will be quite consumed with the internal adaptation process, with fewer resources available for pro-active policy in Eastern neighborhood countries.

¹The recent attacks on the governmental buildings in Kabul are one more omen of a prolonged, if ever possible, mission of keeping this country pacified under control;

²See for instance, Sergei Karaganov et al., *Reconfiguration, not just a Reset*, June 2009;

³Stratfor, “The Lisbon Treaty’s Geopolitical Context”, November 4, 2009;

Furthermore, the EU has continuously remained split over the policy towards Russia, which has substantial stake in the post-Soviet countries on its western wedge. Important 'old' member countries, such as Germany, France and Italy, are especially interested in maintaining strong ties with and are extremely cautious not to upset Russia with extending European sphere of influence in what Russia perceives as its "backyard". Lack of strong response to Russo-Georgian war in 2008, effective vetoing of NATO accession promise to Ukraine, failure to effectively promote common energy policy, divergent responses to latest Russian security initiative are all signs of diverse perspectives that various EU members have towards relations with Russian Federation. It is all too probable that despite increasingly warm stance towards Moldova's European aspirations the EU will remain rather cautious and wary of upsetting Russia too much.

Russia: becoming extremely assertive in its foreign policy

Basic elements: Formally Russian Federation supports territorial integrity and independence of the Republic of Moldova, nonetheless, the Transnistrian conflict and continuous presence of Russian troops and munitions there is a thorn in the relations between the two countries. Russian policy towards Moldova should be viewed chiefly as an element of its regional strategy of restoring its sphere of influence in many former Soviet Union countries. The overarching objectives seems to be blocking further expansion of Western influence and, especially, of Western "security umbrella". Given the developments in Ukraine, Russia appears to view the Western CIS frontier as a "symbolic" line where it is more or less ready to confront Western interests, using for this matter both carrots and sticks if needed. At the same time, it should be mentioned that Russian policy towards fSU countries often lacks perspective (relying mostly on cooperation with incumbent, apparently loyal, regimes) and individualized approach to every particular country, mostly employing 'one size fits all' approach.

Current context: Vladimir Putin's ascension to power was accompanied not only by consolidation of central government's grip on power within Russia, but also with increasingly assertive foreign policy abroad. The "near abroad" has become one of the main venues of action for Russian foreign policy since former metropolis perceives these countries as its legitimate sphere of influence while Western influence as menace to its strategic interests; recovering and preserving influence in key countries such as Ukraine, Kazakhstan and Belarus has become dictum in Russian foreign policy and a matter of survival for Russia and re-establishment of its geopolitical prowess. The Vladimir Putin's remark that Russia would either rejoin the world's leading nations or disappear¹ should be also viewed through the perspective of its neighborhood. The control over its neighborhood is critical for Russia's security and, concomitantly, it is a message to other actors: "I am back". This ascendance was further facilitated by the rocketing fuel prices, fading US involvement in the region, lack of unanimity within the EU on its relationship with Russia, as well as internal weaknesses in the fSU countries.

This is not to say, that Russia's counter-offensive has gone without blunders, such as open support for Viktor Yanukovich in 2004 elections in Ukraine, last gas war with Ukraine in 2009 that apparently awoke EU on the matters of energy security, or support provided for Vladimir Voronin in the late Moldova's general elections of April 2009. Nonetheless, at least in Ukraine and Moldova, Russia deftly managed to partly tilt the situation in its favor after all. In fact, as it was mentioned Russia lacks a coherent vision-dream for its former satellites, nonetheless it often aptly employs various tools, both carrots and sticks, in order to either bring to its heel, influence or destabilize its smaller and weaker neighbors. In the next year, Russia's influence in its neighborhood may well be poised to grow. The launch of the Russia-Kazakhstan-Belarus customs union will help Russia to project its economic interests, despite all the shenanigans surrounding

its ever closer integration with Belarus, while change of political leadership in Ukraine may usher in a period of relative political dominance of Russia on the Western wedges of the CIS.

Ukraine: weakened by political and economic frailties

Basic elements: On one hand, both Moldova and Ukraine are part of the same European package and this background often served as a favorable context for successful joint initiatives, such as EUBAM. On other hand time the relations between two countries were marred by several economic and border disputes (some of them appear to be settling now) as well as Transnistrian conflict. The Ukrainian policy towards the latter issue often appeared to be influenced by different domestic political and business factions. At the same time, prior to the creation of Moldovan SSR in 1940 Transnistria was part of Ukrainian SSR and it appeared nurturing some “territorial hopes” in some political quarters in Ukraine. At the end of the day, Ukrainian policy towards Moldova is not clear-cut and seems to depend a lot on the fluid regional context.

Current context: The Orange revolution, although helpful for political rejuvenation, failed to deliver on its promises of sustainable economic modernization and European integration; its child – the Orange coalition – fell apart in acrimonious fashion leaving Ukrainian people disenchanted. The Western support for Ukraine has also faded away to certain extent. Whatever the outcome of the January elections, i.e. we witness either Viktor Yanukovich’s comeback or Yulia Timoshenko’s rise to power, the bet is a Ukraine less eager to upset Russian interests. Ukraine will not transform into a Russian satellite or ally; in fact, it may well maintain its European integration stance. Nevertheless, it will pursue pragmatic relationship with Russia and, thus, close cooperation in areas of strategic interest for both countries. Most likely, it will abandon its pursuit of NATO membership and will avoid displeasing Russia with unnecessary dramatic gestures characteristic for Yushchenko era. At the same time, Russian business interests will find Ukraine a more friendly terrain since now on. Overall, the Russian influence in the region as a whole will be strengthened.

Although, it should not dramatically influence the state of relations between Moldova and Ukraine for now, Moldovan leadership should be ready for a more reticent Ukrainian stance on some contentious issues, such as Transnistria. At the same time, these shifts will not abort continuous deterioration of relations between Romania and Ukraine. All this, will make regional politics more ‘Balkanesque’.

Romania: transforming in Moldova’s advocate in EU eyes

Basic elements: The Romanian policy towards Moldova is determined by two key factors: (a) its position as a key element of Atlantist political influence and security architecture in South-East Europe; (b) historical ties with right-bank part of the Republic of Moldova, which in some quarters of Romanian political elite are either openly or discreetly nurturing “reunification” dream. In this sense, fundamental objective of Romanian foreign policy is to support European aspirations of Moldova, keep Moldova firmly anchored in its Western drift and stave off as much as possible Russian influence in Moldova. At the same time, Romania is keen to emphasize the “one nation, two states” formula, the “specialty” of Moldova-Romania relations and to keep “reunification” perspective alive. Romania’s refusal to sign basic treaty and border treaty with Moldova only makes some quarters of political elites in Moldova suspect that “reunification” dream is the core factor behind Romania’s geopolitical agenda towards Moldova.

Current context: The “regime change” in Moldova followed by Traian Basescu’s victory in the presidential elections in Romania is generally favorable for consolidation of the Moldova-Romania relations as well as for European aspirations of the Republic of Moldova. Both countries have been quick in showing the warming of bilateral relations. The visa regime imposed by Moldovan communist authorities in the wake of April 2009 unrest on the basis of alleged Romanian involvement in masterminding the street protests was swiftly lifted. The Agreement on small

cross-border traffic was signed and entered into force, while two new Romanian consulates were agreed to be opened in the Republic of Moldova. Furthermore, beyond these niceties, Romanian President is a strongly pro-Atlantist leader, who is likely to carry an active pro-Moldova foreign policy aimed at putting Moldova firmly on European track, ideally as part of the “Western Balkans package”¹. However, the question mark hangs over the ability of Romanian leadership to deliver on its energetic declarations.

Besides these evolutions, the global financial crisis coupled with slow but steady rising as geopolitical star of Asia, has to certain extent shifted focus of the main geopolitical actors as well as limited resources available for pursuing foreign policy goals in the region. However, by the same token, it made many small countries much more vulnerable to influence and bullying from abroad. This is specifically true of countries from the CIS, but also the Balkans. Therefore, the stronger actors able to mobilize limited resources can use them in accomplishing geopolitical goals in the region. Both West and Russia were prompt to offer such resources, however, as crisis’ effects are still unfolding the story is far from end.

Navigating the geopolitical waters...

Although since the mid-2000 Moldova officially declared European integration to be its ultimate foreign policy goal, the road to reach it was bumpy². The social uproar ensued in the aftermath of the allegedly rigged general elections of April 5, 2009, the political crisis and impasse at the background of quasi-civil conflict that divided Moldova’s population in roughly two halves served as both rude awakening for the foreign observers that not all is fine in apparently democratizing and EU-bound Moldova and as a shock reminder for some quarters of Moldovan political elite and population of how shaky are the foundations on which the country’s edifice is built.

The repeat elections held on July, 2009, brought to power anti-communist opposition parties which formed, albeit in a protracted manner, the Alliance for European Integration (AEI). As election of the president failed again, the time will surely test the cohesiveness of the AEI and resoluteness of its leaders, including on foreign policy matters. Quite naturally, the AIE is a heterogeneous entity; and this heterogeneity stretches out to foreign policy matters as well³.

In the aftermath of the elections that saw governing Party of Communists ousted from power, widespread expectations were of fast progress in relations with the EU and Romania and growing strains in relations with Russian Federation. These assumptions have so far only partly passed the reality check. In fact, the picture appears to be a bit more complex than expected in some quarters.

Certainly, the Alliance moved swiftly to consolidate relations with the EU and Romania, in particular. The pro-European aspirations were reiterated while integrationist message re-enforced. However, the pro-NATO rhetoric was dropped and the pledge to abandon the CIS, shared by some members of Alliance, was mooted. Furthermore, Moldovan authorities have been painstakingly cautious to establish pragmatic ties with Russia (progress with wine exports is an eloquent instance of such pragmatism) and maintain strategic dialogue with Russian authorities, and this is despite almost wholesale Russia’s support for Moldovan then-ruling Party of Communists throughout both electoral campaigns of 2009.

Such a down-to-earth approach may illustrate both heightened vulnerabilities of Moldova as well as understanding of core geopolitical constraints influencing Moldova’s foreign policy. The

¹ See for instance, <http://www.rfi.ro/stiri/politica/Republica-Moldova-subiect-de-discutie-intre-Basescu-si-Rompuy.html>;

² See for instance, Euromonitors no.1-17 published by Adept and Expert-Grup, available at www.expert-grup.org and www.e-democracy.md;

³ It also reflects to certain extent the different foreign policy options of the AIE’s electoral constituencies;

least thing Moldova needs now is the external shocks resulting from diplomatic blunders. This is not to mean that Moldovan authorities should adopt policy of foreign appeasement and neglect of national interests. Rather, this policy should be a pragmatic one of pursuing current national overarching objective of European integration/approximation, while taking into account existing constraints and refraining from dramas of sudden geopolitical turnarounds. Such a no-nonsense approach should be also reflected in domestic politics and result in a more cohesive Moldovan society.

The other option available, in fact preferable for some parts of governing Alliance, is forceful drive towards Euro-Atlantic integration aiming at both integration into the EU and NATO coupled with manifest anti-Russian actions and declarations accompanied as well by measures that may be perceived as infringing upon rights of Russian-speaking minorities. Such approach, however, may risk destabilization of both Alliance and the whole political situation in the country; while electoral backlash in the forthcoming elections may bury the Alliance altogether.

All in all, the Alliance is a dynamic and “growing” organism, thus, we can witness features of both approaches as parts of the Alliance strive for common denominator. Not less important, some foreign players may also be in the process of designing and articulating policy and approaches to dialog with new Moldovan leadership. This may sometimes lead to puzzling fluctuations and hiccups in Moldovan foreign policy, however, in longer term the understanding of and adaptation to the constraints and contexts outlined in this analysis will help it settling on a steadier path.

Global challenges

5. Moldova: global challenges for the XXI century

This chapter chiefly focuses on the risks that are not of Moldova's making. However, these risks may well have significant effects over Moldova's present and future. Although Moldovan authorities and society can do little in order to avert or mitigate these risks they certainly should pay attention to them and enhance the capability to adapt to them. Sound adaptation strategies can either minimize the adverse effects or even help Moldova capitalize on eventual benefits. In this chapter we outline four major global risks for Moldova likely to affect the country's development in near and more distant future: global economic crisi(e)s, climate change, scarcer and dearer food, and eventual global energy run-out.

Shifting economic landscapes...

The second half of 2008 was marked by a global financial and economic turmoil of scale not seen since the World War II (see Table 11). For the first time since 1945 the global output shrank. While the end of 2009 showed first timid signs of recovery, the future of world economy is far from certain. Will we witness a strong economic rebound or "double-dip" recession? Or the global economy will settle for a 'new normal' based on sluggish investment and anemic labor markets?²

Table 11 Output by main geographical areas, % change on previous year, 2007-2009

Area/Country	2007	2008	2009*
World	5.2	3.0	-1.1
US	2.1	0.4	-2.7
Euro	2/7	0.7	-4.2
Emerging Europe (CEE, Baltics, SEE)	6.0	4.1	-4.3
CIS	8.6	5.5	-6.7
Moldova	3.0	7.2	-7.0

Note: * - estimate

Source: IMF database.

Furthermore, at the background of the global economic crisis we can see some tectonic geopolitical shifts underway³. The developed, G-7, countries have seen their role diminishing in recent years, while the position of the BRIC⁴ and other developing countries has been considerably entrenched. The search for global solutions to the economic crisis puts a significant emphasis on the importance of these countries, and especially that of China. Any new global architecture

¹ Nobel prize-winning economists Joseph Stiglitz and Paul Krugman as well as Nouriel Roubini are, to name just a few, among those reputable economists who expect American economy to stumble again in 2010;

² See for instance IMF, *World Economic Outlook*, October 2009; The Economist, "The long climb – A special report on the world economy", October 2009;

³ See for instance Roger C. Altman, *The Great Crash, 2008*, Foreign Affairs, January-February 2009;

⁴ BRIC group of countries includes: Brazil, Russia, India, and China.

based on “Bretton Woods”-type institutional arrangement should and, perhaps, will have at its core the new representation system that would more or less satisfy legitimate interests of these countries¹. The G20 agreements appear to be just a first step in this direction².

The last but not the least, these geopolitical shifts are well-illustrated by two open questions. Firstly, as the Anglo-Saxon economic model took thrashing in the wake of the crisis, the majority of national governments of Western and Eastern world alike rushed to offer economy and industry-wide stimulus packages, not to mention colossal bail-outs in the financial sector. Has it been just a short-term measure required to avoid the Japan-style recession or an advent of the drift towards state capitalism? Secondly, the dollar has shed some luster as the world’s main reserve currency. Moreover, America in order to heal it some most critical imbalances would rather see the greenback gradually devalued. What currency should be then at the core of a new global financial system?

Most important, as global leaders are still in the search for most optimal solution and many imbalances and vices at the root of the current turmoil persist, the world economy may well enter the period of reoccurring financial and economic crises of varying degrees.

The evolving international context leaves more open questions than answers for Moldova’s future. The crisis impact was swiftly felt in Moldova, although its effects are yet to be fully shown. Just a couple of numbers to assess the magnitude of the impact: the GDP is estimated to contract by around 7% in 2009, the fixed investment plunged by almost 45%, while exports and imports are set to shrink by 20-30% magnitude, and budget deficit to reach 9% of GDP³.

While the roots of the crisis are obviously out of the reach of the Moldovan authorities they are to find the ways to grapple with its consequences. The constraints, however, abound. As a small and open economy Moldova found itself at the receiving end as the crisis unfolded. Due to the tough financial constraints, magnified by the protracted political hiatus, Moldovan authorities have not been able to resort to stimulus packages employed by wealthier countries. Moreover, the IMF lending will certainly provide a short-time respite for the Moldovan economy, but will it suffice to ensure a necessary upward shift needed to shrug off the lasting consequences of the crisis? Or will the eventual implementation of the Economic Stabilization and Revival Program suffice to ensure economic resilience in the face of reoccurring crises?

Perhaps, in order to weather better the effects of the current crisis as well as to be ready to rebound faster if any new crisis occurs Moldova should aim at accomplishing a triad solution.

Firstly, Moldovan authorities need a new development paradigm that would seek diversifying sources of economic growth. The excessive reliance either on remittances fueling internal consumption or eventual export-led growth can only magnify the impact of global or regional downturn. Moldovan economy cannot thrive and modernize within the patterns of the remittance-based growth seen in the recent years. An innovative approach, in the shape of industrial policy⁴ aimed at increasing competitiveness of the good producers and services providers including with the aim to jump-start the export growth might be appropriate.

Secondly, besides diversified growth, Moldovan authorities should think on creation of a ‘crisis fund’ whose means could be used in order to cushion the first effects of an eventual crisis. Of course, this fund cannot be of a scale to shed the need of international aid for the crisis time, however, it may help the government to stave off some short-term adverse impacts.⁵

¹ See George Soros “A New World Architecture” and Joseph Stiglitz “A Global Crisis requires Global Solutions”, both at Project Syndicate, 2009;

² For a brief overview of the most essential points see: <http://www.guardian.co.uk/world/2009/apr/02/g20-agreements-at-a-glance>;

³ For a detailed account of the global financial crisis impact on Moldovan economy see Expert-Grup, “MEGA: biannual economic review”, 2009 fall edition;

⁴ As advocated, for instance, by Dani Rodrik in “Growth After The Crisis”, May 2009;

Thirdly, in order to finance all these niceties Moldova needs funds. In order to attract these funds from international sources, Moldovan authorities should present a clear vision, with explicit benchmarks and monitoring tools in order to ensure that donors' money is employed for good use. At the international level, Moldova should plead for more anti-crisis aid from the developed countries, as envisaged by the G-20 London agreements.

The Future's warm embrace...

The Climate Change appears to be one of the most daunting challenges facing humankind in the XXI century. Indeed, it is truly global as no country is able to escape its warm embrace. However global it is, many poor countries will find themselves more vulnerable as they are usually located in the more affected southern areas and are lacking financial resources required to pursue mitigation and adaptation policies. Moreover, as many of the developing countries have embarked on the modernization catch-up path, their pro-growth strategies imply more GHGs emissions. In fact, past emissions meaning that the planet is "committed" to Climate Change are accounted for developed world, while more than half of current emissions "belong" to developing countries. Therefore, there is need for a sound trade-off that would ensure economic growth for developing countries combined with the sustainable and comprehensive cuts in GHGs emissions.

Nonetheless, in order to bring to fruition such a balanced approach for economic development the globe needs at least three things: political agreement, financial funds and green technologies. On all of the accounts global efforts are patchy. The COP15 infamously finished with a vague and non-binding statement of principles agreed with China, India, Brazil and South Africa¹. The developed countries are also very far from agreement on how much funds they are ready to devote in order to support mitigation efforts in the developing countries. At the same time, the green technologies critical for "post-carbon" global economy are either unavailable or prohibitively expensive in a way to derail global economic growth².

The situation with no global political agreement, no sufficient funds to support mitigation and adaptation efforts coupled with lack of affordable green technologies underlines the vulnerability of the planet as a whole. However, poor and small countries are the most vulnerable in this respect. They are short of money needed to adapt to the effects of climate change, while finding themselves at the receiving end of the climate change adverse effects without contributing to it to any considerable extent.

Unfortunately, Moldova can find itself exactly among these countries. Although climate change effects in Moldova will not be as dramatic as in more vulnerable southern and sea-shore countries, they still cannot be ignored (Table 12). In the case of both emission scenarios shown in the table increase in annual air temperatures in Moldova can reach on average 4.1-5.4°C. At the same time, a decrease in precipitations is expected, with summers especially becoming drier. The intensity and frequency of extreme weather events, such as droughts, floods, hails, etc. is also expected to rise. All this will have a considerable impact on the most vital natural resources, such as water, ecosystems, land, as well as adverse effects on human health³. Besides that, climate change and need to adapt to its effects may partly or completely transform the ways Moldova sees its future development.

¹ Perhaps, this in a way also reflects new geopolitical realities as well as diminishing foreign policy clout of the EU on a global stage;

² See for instance, Bjørn Lomborg, *Global Warming's Technology Deficit*, Project Syndicate, 2009;

³ NHDR, 2009,

Table 12 Ensemble-averaged projections of seasonal air temperatures and precipitation relative changes (%) in comparison with baseline climate

Season	Emission scenario	Mean air temperature			Precipitation sum		
		Time horizons					
		2010-2039	2040-2069	2070-2099	2010-2039	2040-2069	2070-2099
Winter	SRES A2	1.9	4.0	5.7	7.5	11.4	10.4
	SRES B2	2.2	3.5	4.4	8.5	13.6	15.5
Spring	SRES A2	13.2	26.8	43.2	4.4	6.0	5.5
	SRES B2	18.6	25.3	32.7	6.4	12.3	11.6
Summer	SRES A2	9.3	19.7	32.9	-7.8	-19.3	-30.2
	SRES B2	11.8	18.3	23.8	-13.2	-16.7	-22.6
Autumn	SRES A2	17.8	34.3	55.4	-6.07	-16.0	-17.6
	SRES B2	19.3	34.0	42.3	-6.2	-6.1	-6.8

Note: Winter changes in temperatures are given in absolute values (°C)

Source: National Human Development Report 2009/2010, *Climate Change in Moldova: Socio-Economic Impact and Policy Options for Adaptation*, UNDP Moldova.

There are series of steps Moldova should take in order to adapt to these transformations and to not allow derailing of its development plans; some of them are costly, some not. However, many of the actions to be undertaken are welcome regardless climate change effects. These are quite simple and necessary steps.

One of them is efficient use of the *available* resources. This refers to both local and imported resources. For instance, rational land use coupled with implementation of modern technologies and adapted crops could offset to significant extent eventual losses in agriculture in the aftermath of the climate change effects. However, regardless these effects, these actions would enhance productivity, competitiveness and sustainability of Moldovan agriculture, as well as country's food security overall.

Another good instance is energy efficiency. Enhancement of the energy efficiency of the buildings and equipment would require significant investments. However, rationalizing use of energy through demand management and changing consumer behavior may come rather cheap.

The next action should emphasize investment in infrastructure: transport, power distribution and water provision. All of these are critical for economic development in any circumstances. Nonetheless, well-timed investment in roads, grids and water-pipes will help Moldovan economy and people adapting easier to the changes ushered by warming planet without jeopardizing development prospects of the country.

One more important venue of action should approach the participation in the international and regional adaptation efforts. Given the fact that the EU's role is set to grow in Moldova it would be wise to follow the European lead in this area and rely on its help in adaptation efforts including through broader adoption of the green innovative technologies and practices.

Food for the masses

After several decades of cheap, the new century heralded the rude awakening on that matter (see Chart 19). The prices increased almost two-fold only to recede slightly in the wake of the financial crisis of 2008. However, starting first months of 2009 they have been climbing back. This ominous "reload" of dear food should not come as surprise since all the fundamental underlying reasons are still there: the world's population is growing and so is demand for food. Moreover, the population of the globe is expected to reach 9 billion people by 2050 – who will feed the masses?

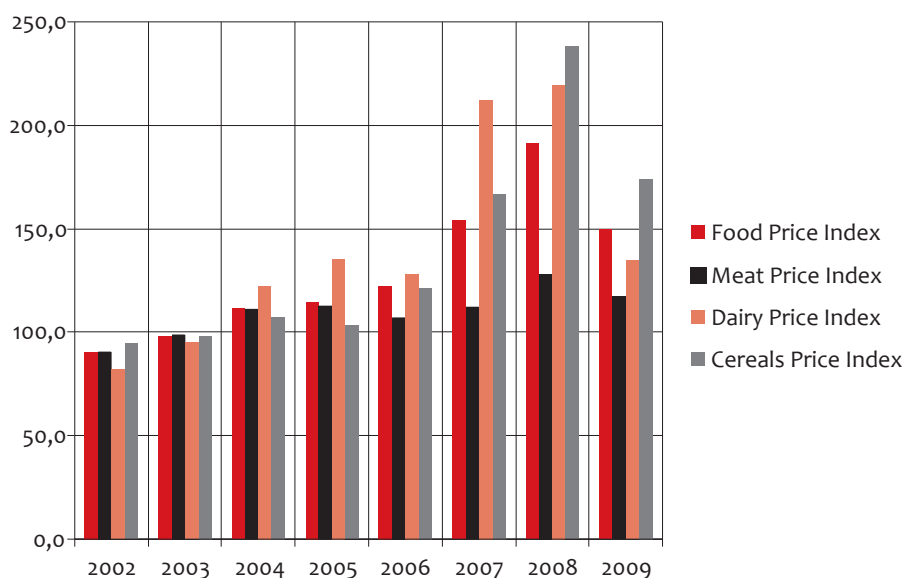
Moreover, world's populations have not only been growing, it has also been getting richer as such populous countries as China and India have started pulling themselves out of poverty. More affluent people consume foodstuffs with bigger protein intake, such as meat and dairy products, production of which requires much more considerable input of feed grains, etc. Although the global financial crisis has dented this drive for prosperity, the trend will not go away. Furthermore, if during the crisis' apex most recession-hit industries in the developed countries operated at 60-70% of capacity, agriculture was at full capacity, last year's cereals crop was the largest on record and there was little fallow land ready to be taken under the plough¹.

The oil world-wide has been getting more expensive and has contributed to more expensive food, as it is used both as fuel per se as well as input for producing fertilizers, etc. Moreover, the "bio-fuel frenzy" led to new significant pressures on agriculture as increasing amount of agricultural land was put to produce bio-crops, such as maize.

Decade-long neglect of investment in agriculture (especially in poor countries) resulted in lower yield growth in developed (from 3-6% last decade to 1-2% nowadays) and flat yield growth in developing countries.

Besides these fundamental factors, the speculative binge on commodity markets coupled with depreciation of the US dollar also supported rise in food prices. Little wonder, recent FAO conference on food security concluded that a new surge in prices like the one seen in 2007-08 is a "realistic possibility"².

Chart 19 Evolution of Food Price Index and Price Indexes for selected products, 2002-2009



Source: FAO.

For Moldova a more expensive food is not necessarily bad thing. Moldovan farmers can benefit from this spike. Nonetheless, the equation is not as simple as: more expensive food = more income for farmers. Such thinking is undercut by more expensive fertilizers and fuel, by soil degradation, convoluted market structure, etc. Thus, in order to benefit from the rising food prices policy action should aim at improving two fundamental variables: production and market access.

¹ The Economist, "Feeding the world", November 2009;

² See "Food prices to stay high, volatile: FAO", <http://www.reuters.com/article/idUSTRE59B2NK20091012>,

In order to boost agricultural production a blend of steps should be taken.

First and foremost, more efficient land use practices should be employed. The transformation of Moldovan agriculture is far from complete and significant part of arable land is worked by small peasant farms that often lack resources for efficient land use. Even on the bigger plots farmers often neglect scientific norms and innovations that aim at preserving land's fertility. Continuous land degradation will undoubtedly imperil any advancement in growing agricultural productivity.

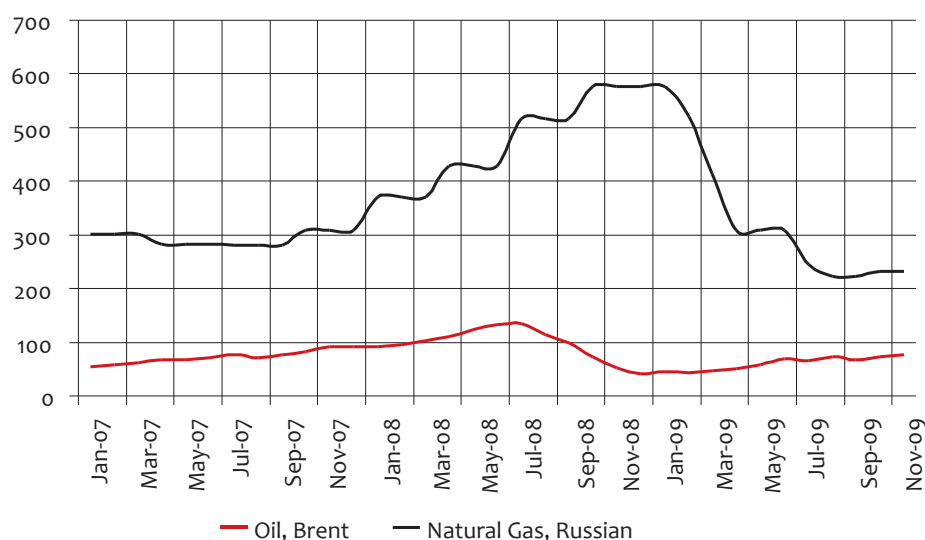
Secondly, stronger attention should be paid to enhancing the agricultural inputs. The instances might include but not be limited to drought-tolerant and pest-resistant crop varieties, disease-resistant livestock, and high-yield agricultural production systems that use less water and capture nitrogen from the air, etc. Such steps would also help Moldovan farmers withstand the threats posed by the climate change that can jeopardize future of Moldovan agriculture altogether¹.

Thirdly, the market structure in Moldova should be reassessed from the standpoint of more fair distribution of profits as the result of agricultural activity. A sprawling network of intermediaries on Moldovan market of agricultural goods is a growing concern and disincentive for investment and modernization of Moldovan agricultural activity both by investors and farmers. It also precludes genuine competition on the market that would benefit producers and consumers alike.

Imperpetuum mobile

The last decade was marked by price spikes in many commodities, but no one was more salient and disturbing than that of oil and other energy resources (Chart 20). The energy is vital for the global economic development and human prosperity and thus these sharp price rises swiftly exposed vulnerabilities of current road to prosperity.

**Chart 20 Oil and natural gas prices, 2007-2009,
USD per barrel and per thousands of cubic meters, respectively**



Source: IMF.

¹ NHDR, 2009;

The underlying cause is certainly the rising global demand for black gold (see Table 13) driven by insatiable drive for economic growth. Since 1995 up to 2007 the global demand for oil increased by more than 22%¹, mostly due to fuel-hungry and briskly expanding Asian economies. For instance, Chinese demand in that period more than doubled. Furthermore, the frenzy on the commodity market driven by the hedge funds magnified the rise in prices to unfathomable proportions.

Table 13 Oil demand and production by groups of countries, million barrels per day, 2007-2009

	2007	2008	2009
Demand			
OECD	25.5	47.6	45.4
Non-OECD	36.9	38.7	39.1
Production			
OPEC	35.5	35.9	
Non-OPEC	50.1	50.6	51.0

Source: IMF.

But besides the demand-side factors, the supply-side developments also played their role. Oil and gas reserved are exhaustible after all and there is ongoing debate that the oil production may have already reached its peak. For instance, from 1960-1985 to 1990-2006 the ratio between discoveries of new oil and oil production went upside down: in the first period the world discovered as twice as much oil as it produced, in the following period the ratio was literally opposite². The jury is still out whether this development happened because of low investment determined by low oil prices in the 1990's or the fact that global oil production has already reached its peak³. However, even if the peak has not been reached yet, it is close. In its most recent estimates usually sanguine International Energy Agency purports that the conventional oil production will reach its peak by 2020, while demand is expected to grow until 2030.

At the same time, the oil production in some countries did not live up to expectations. Oil production in Iran, Iraq, Nigeria and Venezuela was lower in 2008 (10.2 mln. barrels per day) than in 1998 (12.7 mln. barrels per day) due to different reasons ranging from civil strife to neglect of investment. In fact, back in 1998 it was expected to reach by 2008 a production level of 18.4 mln. barrels per day⁴.

There are further two supply-side constraints.

The first one is climate change. On the one hand, the world will, sooner or later, reach a binding agreement on cutting CO₂ emissions. Such an agreement, although may dent somewhat the demand for oil, will also make non-conventional oil resources less feasible as their extraction requires much more energy to extract and thus might lead to more CO₂ emissions and air pollution. At the same time, the level of productivity of various renewable sources of energy is far from required in order to ensure success in continuous quest for economic growth and prosperity.

The second constraint is the fact that oil and other energy resources, such as natural gas, have become increasingly politicized. For instance, the overwhelming share of oil and gas production is currently in the states' hands. This basically means that the revenues are used for the domestic and foreign politics ends even at the cost of lower investment in production and exploration,

¹ Hereinafter, the data of International Energy Agency is used;

² The Economist, "2020 Vision", December 2009;

³ See more on "oil peak" debate in Special Report "OIL: The Long Goodbye" in Foreign Policy, September-October, 2009 as well as *Has Oil Production Peaked*, Bassam Fattouh, Project Syndicate, 2009.

⁴ Roger C. Altman, *The Great Crash*, 2008, Foreign Affairs, January-February 2009;

while energy supply is sometimes seen as the most feasible tool to achieve geopolitical goals by some producing countries. By the same token, consuming countries often employ different instruments in order to ensure their access to these strategic resources.

Some countries can boast “geological endowments”, while others ability to project its geopolitical power (or both) in order to ensure access to oil. There is also a third group of countries with neither geology blessing nor geopolitical clout or other resources ensure stable access to energy resources ... and Moldova is lucky enough to find itself in this latter group of countries.

The predicament faced by Moldova is further complicated by some concerns over the reliability of supply, i.e. Moldova has to import over 90% of energy resource in order to satisfy its needs, while sometimes the supply of natural gas is jeopardized due to the Russo-Ukrainian tussle over the gas price issues¹. In this sense any energy security strategy should pursue a two-prong strategy: to limit external vulnerabilities by scaling up local power production² and changing mix of the energy used in economy; and by striving for diversification of supply, especially of natural gas.

Certain shedding of dependency on the imported energy resources can be attained through the combination of measures. First of all, local production capacity should be developed. Given Moldova’s natural endowment such a progress can be achieved only in small-scale hydro-power generation and renewable energy resources³ (of which biomass has the biggest potential, but also solar and wind energy) development both for power and thermal power generation. Secondly, more attention should be paid to energy efficiency and conservation with the aim at modernizing equipment and production process (both in energy production and in non-energy sector) and buildings; as well as improvement of transport infrastructure with the view of cutting losses. Tariff policy favoring energy-savers, i.e. consume less – pay less per unit consumed, may also be helpful. Thirdly, the balance of energy used should be tilted towards more power consumption and less natural gas consumption. This will also reduce the vulnerabilities caused by limited reliability of natural gas supply.

Finally, diversification of gas supply will remain a contentious issue. Although accession to the Energy Community Treaty accompanied by significant internal market liberalization will help diversifying access to power supply on a competitive basis, the diversification of gas supply will remain a distant prospect so far as Moldova remains tied up to the Gazprom gas supply. Participation in the prospective new gas routes is attractive, but would be costly while these routes have remained so far mostly on paper. The reverse connection with Romanian gas transit network looks much more attainable and cheap at the moment both as a back-up option in the case of a sudden disruption of supply and as a longer-term option for diversification of supply.

¹ Moldova not only imports natural gas from one source (Russia), it also comes via one transit country (Ukraine) leading to double “geography” curse;

² The Cuciurgan power plant situated in break-away Transnistria region and privatized by Russian company RAO EES has the needed capacities to cover Moldova’s power needs as well as to produce power for export. Although currently Moldova buys power from this power plant via unclear price scheme it has no sway over the activity of the plant. At the same time legitimacy of privatization of the plant is questioned by many policy-makers of the right-bank Moldova;

³ For more information see Government of the Republic of Moldova, *National Program for Renewable Energy Resources Development 2003-2010*;

Policy implications

6. Policy implications and recommendations

In this concluding section we firstly try to convey the readers some key messages that we believe should influence the policy agenda of the current and future governments in Moldova. Then we enlist a series of key challenges, risks and opportunities that already do or are likely to influence development of Moldova as a state and put forward some policy options to address them.

Key conclusions from the analysis

Unfortunately, Moldova has not been blessed with either significant reserves of natural resources or productive capital. Land is the only abundant resource but it has not been valued economically so far and is subject to man-made erosive process threatening its productive and regenerative capacity. At the same time, there is too much land in Moldova allotted under inefficient agricultural activities and too little for industrial purposes, including for the infrastructure necessary for the agricultural sector growth. Short of natural resources and capital, Moldova has to put in place more clever development strategies relying mostly on better-trained human capital and skillful absorption/development and use of technologies, including those that are energy-, water- and land-efficient. ***Lack of own energy resources and growing deficit of water resources will remain in the future among the most fundamental constraints limiting not only the country's economic development but also its geopolitical options.*** As human resources represent the most available resource for Moldova to use for its economic development, increasing the labor productivity through better education, innovation and technological development/transfer should be a paramount objective on the agenda of any government that care about Moldova.

Against most of the transition countries, Moldova has made very modest economic progress after becoming independent in 1991. ***As a net assessment, Moldova was not able to make use of its natural endowment and human resources and to overcome its geographic and structural weaknesses and thus to achieve higher living standards for its population.*** Massive labor migration is the best litmus test for this failure. Inconsistent and incoherent economic development policy has been one of the key factors behind Moldovan economic drawbacks. The Moldovan governments were not able to get rid of Soviet-type practices of interfering in private business; on contrary, after 2001 the situation worsened even more, as the power vertical penetrated not only the public administration but also the private sector. Moldova was not successful enough in dismantling its system of erratic business regulation and to attract and retain foreign (as well as domestic) investments. No surprise, the economic growth achieved between 2000 and 2008 ended when its main engine – migrants' remittances – contracted. Financial markets are still feeble and unable to provide the much necessary investments at a reasonable cost. With its exports growing rather slow and imports mostly concentrated in non-substitutable items, the country has also suffered of a rapidly worsening terms of trade. A key conclusion is that the true economic modernization of the country is yet to be achieved and unfortunately, if it proceeds at recent speed, this task will span over many electoral cycles if not decades.

Moldovan society is quite heterogeneous and divided. Obviously, there is no easy fix to the latest predicament. However, it would be sensible to follow the path that would not make these dividing

gaps deeper. This would not require any extraordinary efforts; rather it would mean **avoiding actions that would alienate and disfavor any ethnical, religious, etc, social groups**; it would also ask authorities **to refrain from forcing “identity solutions” on social groups opposing it**.

By the same token, the constitutional reform should be approached with care. In short term, the only constitutional provision that appears to be in need of amendment is the one on the election of Moldova’s president. This protracted stalemate seems to be a real block in further country’s development and its dismantlement is in the common interest of Moldovan people and all political parties. Thus, its modification is the least common denominator for the leading political parties in Moldova.

On the external front the key message is to fill the pro-European policy course with practical meaning: **the words should be matched by deeds**. In other words, all external and especially “pro-European” commitments should not be left on paper, but **mirrored by deep and comprehensive domestic reforms**. At the same time, open and cooperative relations with other regional actors should be promoted, while unnecessary and provocative statements or actions (projected either outwards or for domestic political use) should be avoided. The European integration process should not be dramatically effervescent, but rather a calm and dull process.

Moldova’s development framework assessment and policy options

Development threat/challenge/risk/ opportunity	Policy options / strategy
Due to its geographic location and poor transport infrastructure, Moldova is economically remote and unattractive as transit route. At the same time, as shown by the Giurgiulesti case, private developers possessing state-of-art management and industrial know-how can successfully develop a Moldova-based international logistics services sector.	<ul style="list-style-type: none"> Streamline and get more transparent the customs procedure, including through wider use of electronic technologies, with the purpose of speeding up the customs traffic; Keep on attracting EU funds and make better use of own resources for restoring/building bridges connecting Moldova with Romania, Moldova with Ukraine and the Nistru river right-bank Moldova with the left-bank one; Conduct feasibility assessment of a wider set of technical solutions to speed up the traffic and increase the volume of rail-road cargoes between Moldova and Europe via Romania; Amend the Land Code to simplify the procedure of changing land destination (especially from agricultural to constructions) with the purpose of streamlining the creation of various types of industrial parks, including those providing international logistics services; Based on the Giurgiulesti example, continue attracting international companies to develop logistics services hubs in Chisinau, Cahul, Balti, Ungheni, and Marculesti;
Most of the Moldova’s citizens live in very small and quite disordered rural communities, suffering of poor or totally absent access to basic public services, including safe water, and faring a depressive social and cultural environment. Providing cost-effective housing and transport infrastructure to these communities and developing a more socializing cultural environment remains a key challenge for the government.	<ul style="list-style-type: none"> Strengthen electric power grid across the country and promote electric power-based solutions for heating private houses and public buildings in rural communities as alternative to natural gas; investing more in electric-power grid (as well as generation) and developing international grid connections is also a more intelligent solution for the long-term perspective when natural gas will deplete or get too expensive; Promote in rural areas use of waste-to-energy technologies (including methane from biomasses, straw-fired power and heating plants), wind and solar power generators, and energy conversion and insulation technologies; Promote use of non-pollutant, energy-efficient sewage and water treatment systems based on ecological sanitation principles;

Development threat/challenge/risk/ opportunity	Policy options / strategy
	<ul style="list-style-type: none"> Promote cost-effective and environment -friendly solutions for the livestock sector in Moldova, and encourage the livestock transfer outside the perimeter of the communities in the corporate sector; Use existing international funds to create appropriate waste disposal areas in each rural and urban communities and adopt more severe fines for improper waste treatment and disposal and effectively enforce them;
<p>Moldova has very limited natural resources, including basic ones such as energy and water. On the other hand, Moldova's reserves of land and of some mineral resources are quite high, even though not properly used.</p>	<ul style="list-style-type: none"> Conduct comprehensive geologic audit and economic assessment of the country natural resources, including of the rare mineral resources and adopt a program for more efficient mining/operating the existing reserves; Promote adaptation of existing and/or development of innovative energy-efficient, water-efficient and waste-free processing technologies as integral parts of economic processes and social life; Promote land rehabilitation technologies tailored to the needs and financial resources of the small-scale farms; Enforce effectively and universally the provisions of the Land Code regarding land protection measures; Make the land available for purchase for non-residents to increase investment in agriculture and spur income of the rural residents;
<p>During the early transition period Moldova lost a sizeable part of its labor and human capital. With migration easily available, Moldova still continues losing it. Temptations to migrate will decline as domestic salaries grow; but in the foreseeable future migration is set to remain an integral part of the Moldova's development model.</p>	<ul style="list-style-type: none"> Moldovan state needs to ensure effective protection of its citizens anywhere in the world through its diplomatic service and through promotion of adequate enforcement of international and bilateral agreements; Moldova needs to effectively reform its education sector and get rid of corruption in order to render Moldovan diplomas internationally recognized and thus to provide more chances to its citizens to find better jobs abroad; Create an efficient, independent and impartial Agency for academic accreditation of the all post-secondary educational institutions; Allow more financial and administrative autonomy to universities, colleges and vocational schools, create Advisory Boards in each education institution as bodies entitled to overview the management practices and make educational institutions more publicly accountable; Encourage foreign universities and vocational schools to open subsidiaries in Moldova and engage in European education projects in order to significantly contribute to the human capital development in Moldova; Adapt training curricula to market needs by establishing partnerships between education institutions and employers; Encourage university-based research, technology development and innovation process;
<p>Poor productive capital is a key constraint undermining labor productivity. Moldova needs much more public, private and foreign investment in order to narrow its technological and productivity gap with other countries in the region.</p>	<ul style="list-style-type: none"> Adopt creation in Moldova of the most attractive regulatory environment in Central and Eastern Europe as political goal of the government and use experience of the front-running Singapore, Estonia, Hungary, Georgia in this regard; Specifically, streamline the change in land destination and issuance of the building permits procedures;

Development threat/challenge/risk/opportunity	Policy options / strategy
	<ul style="list-style-type: none"> • With the same purpose, ensure better protection of the investors rights and enforce accountability of the executive directors in public and private joint stock companies; • Support consolidation of the available land (either by local/regional public authorities or private developers) with the purpose of creating a national system of industrial parks in most urban communities in Moldova (classical industrial parks, agro-processing parks, eco-industrial parks, logistics parks, etc.);
<p>Not a long time ago, the Moldovan version of the economic policy meant an arbitrary and opaque practice enabling the government to effectively control the business through the state control bodies, a vast and inefficient public administration and a perverse system of pecuniary payments and imposed social responsibility. If not abated, this tradition will resurface and completely undermine the domestic private sector.</p>	<ul style="list-style-type: none"> • Moldova needs more functional and independent market regulatory agencies in order to effectively impose universal rights and obligations for all market players, including for the Government and for the state-owned enterprises (Agency for Protection of Competition, Agency for Energy Regulation, Agency for Transport Regulation, Agency for Electronic Communications and Information Technologies, and others); • It is necessary to create a public independent agency to effectively protect the consumers rights; • Sector-wise joint working groups have to be established by the government and the business as means of rebuilding mutual confidence and adopting transparent policy decisions; • Key to abolishing the system through which the government and state control bodies exert excessive interference in private business is a functional and independent justice system; enabling such a justice system should be among the priorities of any benevolent government in Moldova;
<p>After the initial macroeconomic chaos in early transition period, achieving a more stable macroeconomic environment in Moldova was precluded by high public budgetary commitments (comparable to OECD average in relative terms) and lack of necessary institutional and structural measures to redress inflationary pressures.</p>	<ul style="list-style-type: none"> • Moldovan government has to achieve the much necessary intra-budgetary optimization of the expenditures in order to let the economy grow faster than the budget in long term; a strategic option in this regard would be to allow more private initiative, including through public-private partnerships, in the areas which so far have been traditionally seen as governmental sphere: maintenance, repair and construction of roads and rail-road, administration of free economic and industrial zones, maintenance of public parks, squares, etc. • Combating inflation in long run requires, aside from traditional monetary policy tools, a more efficient mix of structural and institutional measures to make markets competitive, prevent trust agreements and dramatically improve energy efficiency across economic sectors and households.
<p>Moldova has got a rather underdeveloped financial system which is unable to amass domestic savings to transform them in long-term deposits and to finance investment. Presently, the commercial banks are in rather difficult situation (even though less troubled than in all other countries in the region) because of the increasing share on non-performing loans concentrated in two sectors (constructions and winemaking) with potentially escalating risks.</p>	<ul style="list-style-type: none"> • Government, National Bank of Moldova, commercial banks and debtors have to discuss and adopt a mutually agreed plan of restructure of non-performing loans in order to prevent situation worsening with potentially more destabilizing effects; • Attract more strategic investment in the Moldovan banking sector while monitoring carefully the sector exposure to external and currency risks;

Development threat/challenge/risk/ opportunity	Policy options / strategy
<p>Moldova has achieved a decent degree of geographic diversification of its foreign trade and a high level of integration in the world economy. However, because of the worsening terms of trade and growing needs of a growing economy, Moldova's foreign trade is utterly unbalanced.</p>	<ul style="list-style-type: none"> • Moldova has to sell larger volume of more valuable exports in order to accumulate the currency necessary to cover its non-substitutable imports. Achieving this in short run is not possible and the country is set to run high trade deficits in the near future. In long run, the exports capacities will grow as effective economic output converges to its potential. The options presented above will contribute to this. More specific policy options follow: • Ensure transparency and effective enforcement of the quite simple customs procedures; • Get rid of all anti-competitive import arrangements; • Streamline the system of technical authorization and product quality and safety certification; • Adopt EU regulations in the veterinary and phytosanitary sectors;
<p>Moldova's society is highly heterogeneous and often divided along ethnical, religious and other lines. To make picture more complex during last two decades no internal social core based on civic values has been formed, while magnetism of external "anchors" (former metropolis) has been steadily growing. At the same time, dividing lines risk getting deeper due to political manipulation and dissatisfied citizenry. Moldovan government should focus on solutions favoring all society groups aiming at nurturing sentiments of civic satisfaction.</p>	<ul style="list-style-type: none"> • Friendly, open and efficient public officials dealing with citizens would increase citizens' trust in the state institutions and loyalty to the state as a whole. This would help fostering stronger civil identity. In such countries as Moldova civic identity should come first; ethnical or any other – the second; • Comprehensive implementation of E-governance Program would result in citizens' satisfaction in dealing with the state officials. This satisfaction would cut across different ethnic, religious and other lines; • Targeted policy measures (such as social compensations) should be assessed properly before implementation (not like in case of transport compensations in Chisinau municipality) and afterwards explained properly to the stakeholders in the process; • Promote joint cultural events, including via public TV and radio. Support for cultural events should gradually shift from events for distinct cultural groups to joint events that would facilitate cultural exchange and communication between different groups in the Moldovan society; • The state-supported events should not mirror those promoted by the foreign Embassies, rather they should focus on helping its citizens with different cultural backgrounds to communicate and to learn from each other; • Make Moldovan citizenship attractive to the country's inhabitants both on the right and left bank of Nistru: negotiate a visa simplified-to-free regime with EU;
<p>Political and civic participation has been at historical lows, with citizens being increasingly disenchanted with their public representation. Public dissatisfaction erodes trust into state institutions and may sometimes result into civil unrest. What is really needed is to provide venues for transparent participation of different social groups, however, without jeopardizing efficiency of the governance act.</p>	<ul style="list-style-type: none"> • The participatory process should be filled with substance and involved groups should have real say in the consultation and decision-making process; • The specific policy measures should be routinely discussed with the stake-holders representatives via permanent and ad-hoc formed working group meetings; • Media presence of all political parties should be ensured via public TV and radio. Retaliation measures should be avoided as much as possible. • Proper investigation of the post- April 5 elections should be ensured. Generally, public should be properly informed on the investigation of announced corruption cases, anti-competitive arrangements, etc.

Development threat/challenge/risk/opportunity	Policy options / strategy
<p>Security system in Moldova is fundamentally flawed, and this refers to all its institutional components. There is a deeply enrooted culture of repression in the law enforcement bodies. Judicial and prosecution bodies preferred to be politically submissive rather than genuinely independent.</p>	<ul style="list-style-type: none"> • Unfortunately, it seems that security system in Moldova cannot be restructured from inside; a very strong political will is necessary to create and maintain the reform impetus, which should start with demilitarization of the headquarters staff in all security bodies; • Justice and prosecution will become independent only if they become publicly accountable and right (both positive and negative) economic incentives are put in place, without undermining the willingness of the well intentioned judges and prosecutors to enforce the law;
<p>The current government faces a tall order of proving Moldova's European credentials after years of half-hearted efforts. While EU remains consumed with domestic institutional reforms and divided on certain foreign policy matters, Moldova has consistently failed to deliver on its euro-commitments. Moldova's European aspirations will not be taken seriously and will not be seen as "urgency" if the country continues to fail with its homework.</p>	<ul style="list-style-type: none"> • Moldova should focus to the effective implementation of the commitments taken in front of the EU; • Moldova should aim at ambitious goals with important value for its citizens and make them part of the joint commitments with the EU. Although the EU may be reluctant to concede such commitments it is in Moldova's interest to assure European counterparts that ultimate realization of these commitments is only possible if Moldova thoroughly implements the attached roadmaps and action plans. This will ensure that full realization of these commitments does not result in additional burden or risks posed by Moldova to the EU. For instance: <ul style="list-style-type: none"> ✓ Agreement on visa free travel would require implementation of an action plan aimed at ensuring proper border control, migration management, etc. ✓ Agreement on free trade would require Moldova to enforce competition rules, implement quality and safety standards, etc. • Shift from emphatic declarations (like becoming EU member in two years time) to groundwork. Many countries with less European perspective and less rhetoric have attained some enviable practical progress, like Belarus agri-businesses exporting meat to the EU.
<p>Russia's presence in region becomes stronger, while due to its sheer size it holds considerable leverages over many countries in the region, including Moldova. With friendlier regime in Ukraine, Russia may demonstrate more interest and more elaborate policy towards Moldova, which appears to be quite divided on matters of policy towards Russia. For Moldova it is crucial to find the way to deal with this player without being submissive with respect to its national interests.</p>	<ul style="list-style-type: none"> • Keep regular clear-air meetings with Russian counterparts to ensure proper communication and avoiding erratic spirit of the relations in the communist era; • Work together with Russian counterparts in order to ensure that interests of Moldovan companies and citizens in Moldova are observed and respected; • Convey a message of "respect" to Russian Federation, but stick to European integration overarching priority; among others ensure Russia that: <ul style="list-style-type: none"> ✓ Its economic and investment interests will not receive a discriminatory treatment; ✓ Russian-speaking minority's rights will be respected and it will receive equal treatment in Moldova, while Russian-language media will not be closed or bullied but rather treated in line with the national legislation; ✓ Underline Moldova's intention to stay neutral; ✓ If there are pressures that would impede Moldova's progress on the EU integration (for instance, energy issues) be diplomatic enough to show that these pressures go against Moldova's European commitments and involve the EU if necessary; ✓ Keep reminding Russia about its commitments with respect to Transnistrian conflict, but be ready this show would go on for some time. With European support wage a war for hearts and minds of Transnistria's inhabitants, including cooperation projects on community and business levels.

Development threat/challenge/risk/ opportunity	Policy options / strategy
Romania is set to substantially increase its role as Moldova's advocate in the process of European integration.	<ul style="list-style-type: none"> • While this development is welcome and well-intentioned, Moldovan authorities should be cautious that these efforts do not end up counter-productive for the domestic policy agenda. • The Romanian advocacy agenda should be coordinated with Moldovan policy agenda. • Moldova seeks to preserve its statehood; so any unionist statements should be kept in check.
Ukraine is in post-electoral transition; it will take some time until its policy agenda takes clearer shape. The bet is it will become more Russia-friendly, while preserving its course towards European integration. Ukraine holds key (at least one of them) to Moldovan security and European integration. Moldova should be keen to preserve friendly relations with this country and closer cooperate where it suits Moldovan interests	<ul style="list-style-type: none"> • Sort out all remaining contentious issues, such as property, territorial disputes, etc.; • Closely cooperate with Ukraine on matters of European integration (but also cooperation in energy issues), including experience exchange where one of the country is more advanced (for instance, FTA negotiation). However, if supported by the progress on the ground, it may be reasonable for Moldova to decouple itself to Ukraine and fast-forward on its path; • Some prominent figures in Ukrainian political establishment have Moldovan roots, it is sensible to use these "emotional" bonds to good ends in cooperation between two countries;

Annex

Annex: overview of the results of the sociological survey “Moldova 2009: state of the country and of the people”

Sample size: 1070 persons aged 18 and above.

Sample: stratified, probabilistic, three-stage.

Stratification criteria: 12 geographic regions, residential area (urban/rural), size of urban areas (four types), type of rural areas (commune/adjacent village).

Randomization stages: Community (75 preselected communities, 208 sampling points), Household/Family, Individual.

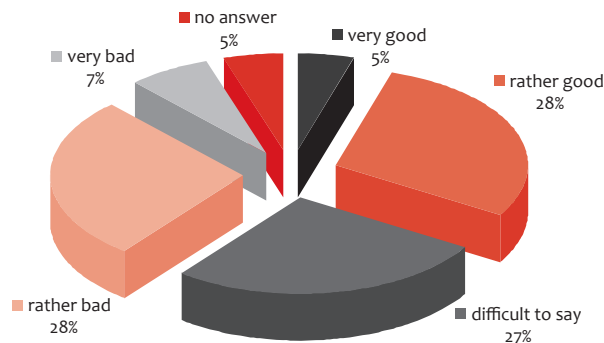
Representativeness: the sample is representative for the adult population of the Republic of Moldova (except Transnistria region), allowing for a maximum error of $\pm 3\%$.

Data collection period: October 11-29, 2009.

Structure of the sample:

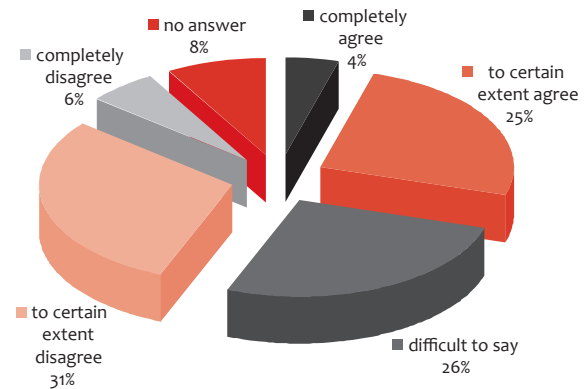
Variable	Group	number of respondents	%
Gender	Male	423	39,5
	Female	647	60,5
Age	18 - 29 years	230	21,5
	30 - 44 years	239	22,3
	45 - 59 years	303	28,3
	above 60 years	298	27,9
Education	Incomplete secondary	247	23,1
	Secondary of vocational	434	40,6
	Upper secondary	158	14,8
	Tertiary	226	21,1
	no answer	5	0,5
Occupation	Private entrepreneur	49	4,7
	Employee	265	25,2
	Temporarily unemployed	268	25,5
	Unemployed	471	44,7
	no answer	17	1,6
Nationality	Moldovan/Romanian	832	77,8
	Russian	63	5,9
	Ukrainian	88	8,2
	Other	69	6,4
Household's monthly income group	Below 500 lei	104	9,7
	501-1000 lei	250	23,4
	1001-3000 lei	313	29,3
	above 3001 lei	142	13,3
	no answer	261	24,4
Area or residence	Urban	442	41,3
	Rural	628	58,7
Type of community	Chisinau	196	18,3
	Other community	874	81,7
TOTAL		1070	100

Do you believe that Moldova's image in the world is ...



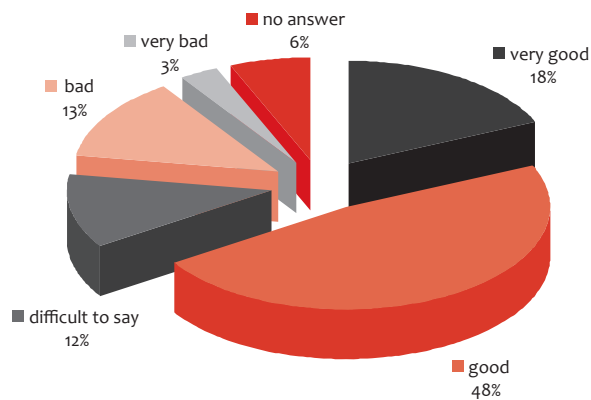
The answers are distributed rather equally, with balance slightly tipped into negative. However, some improvements in comparison with 2007 are noticeable. Capital-city residents as well as elderly tend to have positive perceptions regarding Moldovan image abroad.

To which extent do you believe that Moldova successfully promotes its interests in the world?



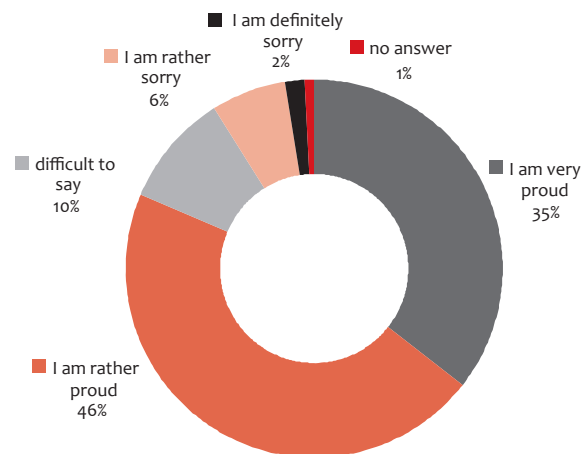
Slightly more respondents believe that Moldova fails to effectively promote its interests abroad. In comparison with 2007 the balance worsened somewhat. Quite interestingly, least educated, self-employed along with ethnical Russians respondents being apparently most satisfied with Moldova's ability to promote its interests abroad.

How do you appreciate the Republic of Moldova in general, as a place of living?



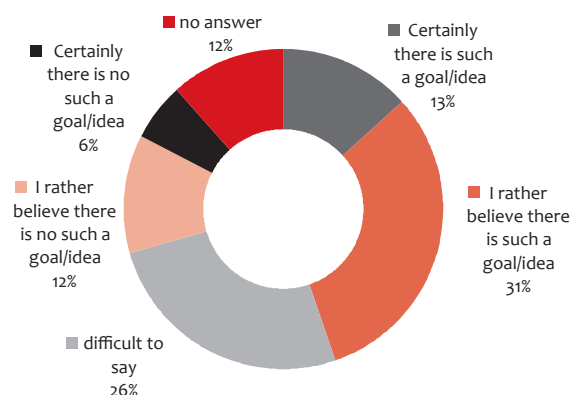
Moldovans are in love with their country, at least this is what the answers to this question show. A significant progress can be attested in comparison with 2007. However, this affection is weaker considerably in the case of ethnical Russians, young people and temporarily unemployed.

What feelings do you have in connection with the fact of being citizens of the Republic of Moldova?



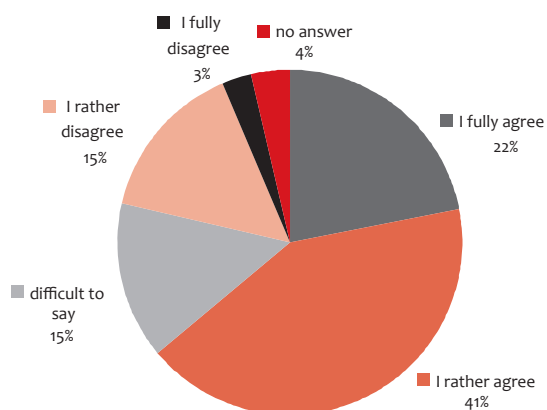
It's been from good to better for Moldovan patriotism. The numbers of those proud to be Moldovan were high in 2007; they got higher in 2009. Importantly, the degree of patriotism depends a little on educational or ethnical background, gender or income. It is a bit lower in the case of Chisinau inhabitants and ethnical minorities.

Some citizens believe that in our country there is a common goal or a common idea uniting all the people. What do you believe about this?



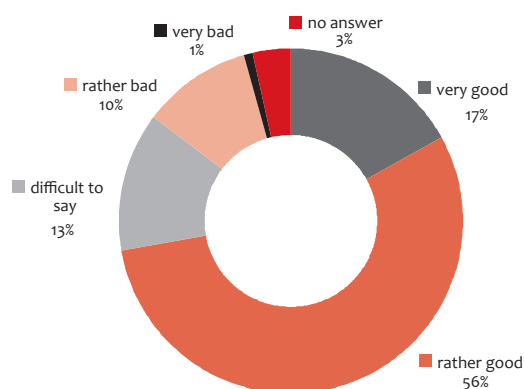
Again the survey shows a rather positive evolution from 2007 to 2009. Almost half of all respondents believe in a common idea, with highest support in Chsinau and among persons with higher education. Ethnic Russians are a conspicuous exception in this respect. After all, only one question is hanging in the air: do all these people have a common idea in mind?

To what extent do you agree with the affirmation that education in our society can ensure one's success in life?



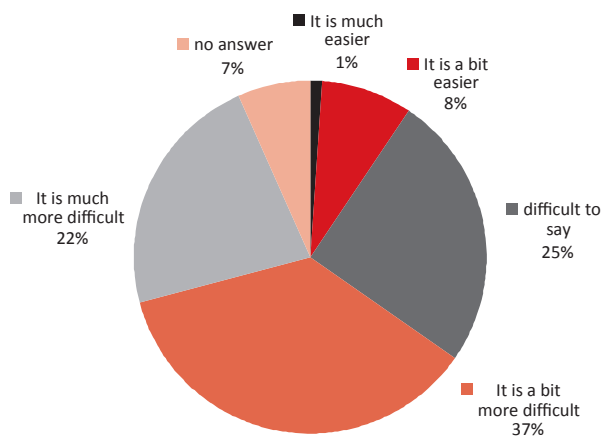
The education has been becoming more of an asset for Moldovans. Even more Moldovans believe the education will help them make their way to success in life. It is almost general belief, with only self-employed and people of other (than Moldovan, Ukrainian, Russian) nationality being a bit more cautious in this respect.

How do you evaluate the relations between people of different ethnicities living in the Republic of Moldova?



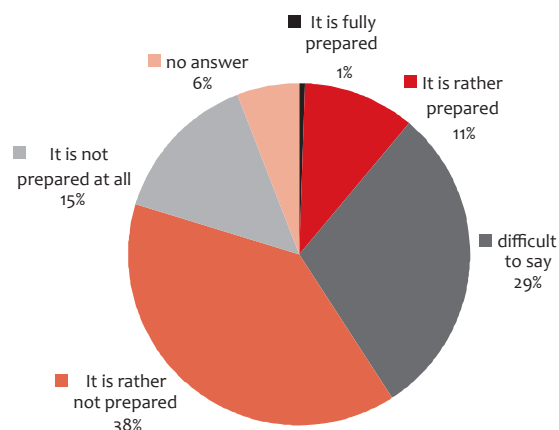
The picture is a bit bleaker than in 2007, nonetheless, broad majority is pretty content with the state of inter-ethnic relations in the country. Moreover, this is the matter where no major differences can be observed among people of different backgrounds.

In comparison with the situation in the previous year, is it easier or more difficult today to find a well-paid job in the Republic of Moldova?



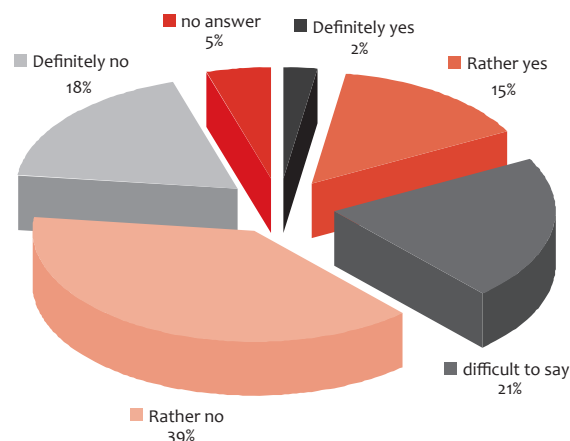
The survey shows that the prospects have been getting dimmer. It is particularly true for the people aged between 30-59 age, self-employed and those with lower education level. Residents of the capital certainly live in a brighter reality as they see their prospects to get well-paid job with more hope. This gloomy picture should not surprise, as crisis has certainly hit Moldova.

To what extent, in your opinion, is our country prepared to face calamities (for example, droughts, floods, big fires)?



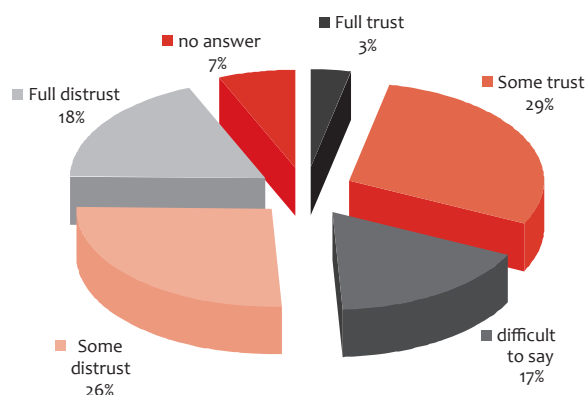
The situation has got worse somewhat. Only tenth of Moldovans believe that the country is prepared to face calamities. This disbelief in the country's ability is wide-spread and equally shared between different groups of population. However, the self-employed are the most skeptical.

If you, or your close relatives were in a difficult situation (due to a sickness, loss of a job, natural calamities etc.), do you believe you could count on full support from the state?



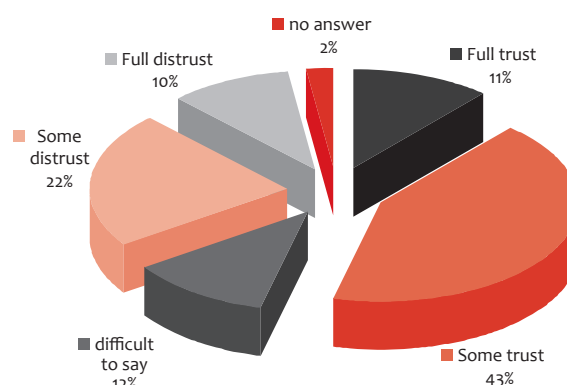
The share of those hoping for helping hand of state in the case of need has grown somewhat, but remains meager: less than one-fifth of citizens nurture such hope. The expectations are particularly low in the case of younger people, self-employed, Chisinau residents and ethnic minorities.

How much trust do you have in the domestic banking system?



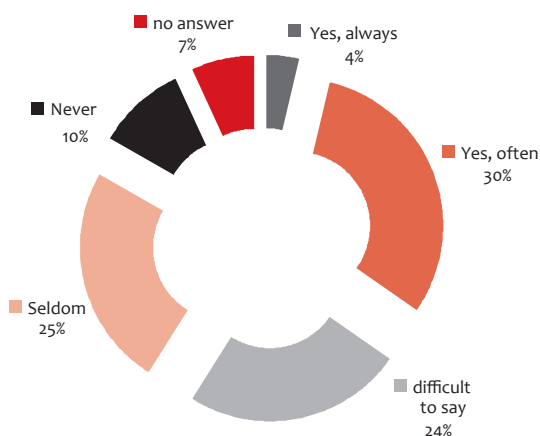
Despite all gloom and doom, Moldovan banking system remained as much stable as it was in 2007; at least, this is what Moldovan citizens think. The overall trust in banking system barely budged from 2007 to 2009. Notwithstanding, it is still rather low, with majority of citizens still anxious of the creditworthiness of the bank systems. The only categories with prevailing trust in banking systems are residents of Chisinau and people with high incomes (over 3000 MDL). Well, perhaps, they know better...

How much trust do you have in local public administration from you community?



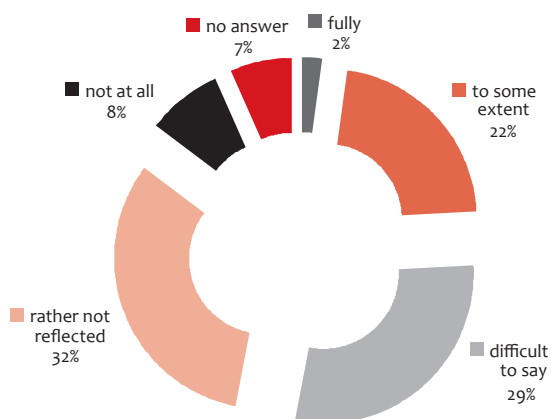
The distribution of answers show that majority of citizens do trust their local public administrations. What is important, this trust substantially consolidated from 2007 to 2009. The trust is the highest among the capital-city dwellers.

Do you believe that ordinary citizens can directly, or through initiative groups, influence decision-making in your community?



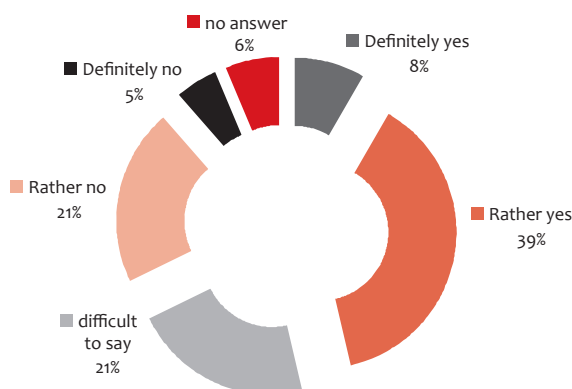
Majority of Moldovans still believe they have little say over the decision-making process at the community level. Although, the situation has improved somewhat. Your voice has more chances to be heard if you live in Chisinau, have high incomes and education, and/or belong to ethnic majority. Sorry for the rest...

To what extent do state policies reflect your interests and expectations?



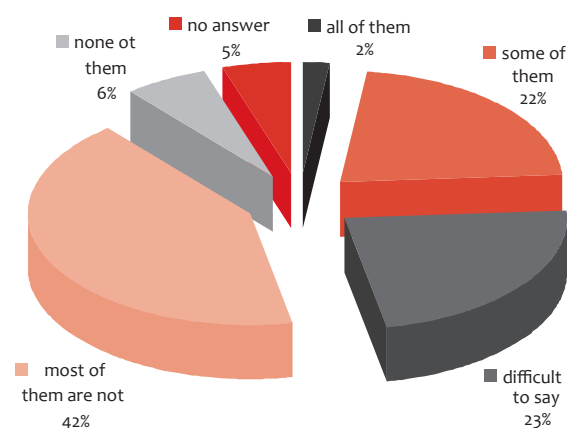
Less than quarter of respondents see their interests and expectations reflected in the state policies. This picture is worrisome, although situation apparently improved slightly from 2007 to 2009. Most dissatisfied with the state policies are those aged 30-44, having vocational education background, being simple employee, coming from ethnic minorities and/or urban area other than Chisinau, and having low income. On the opposite pole, are Chisinau dwellers whose views are squarely divided on this matter.

Do you believe that by participating in the elections you can influence the situation in the



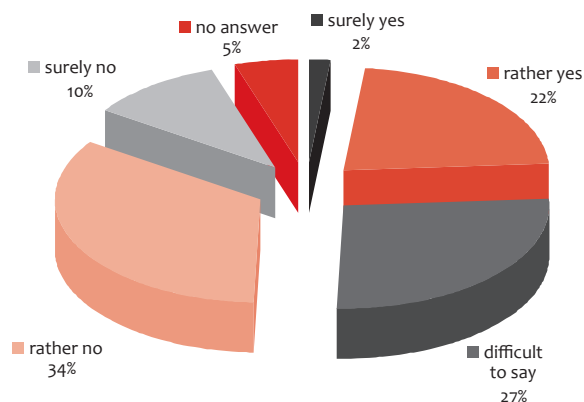
Your vote matters after all. The distribution of answers shows that more Moldovans believe they can change things via elections than those who do not. This statement is especially true in the case of those with high incomes and education as well as living in Chisinau. On the opposite side, the disgruntled voters mainly include self-employed, ethnic minorities (again!) and urban areas other than Chisinau.

Do you generally believe that your rights are respected in our society?



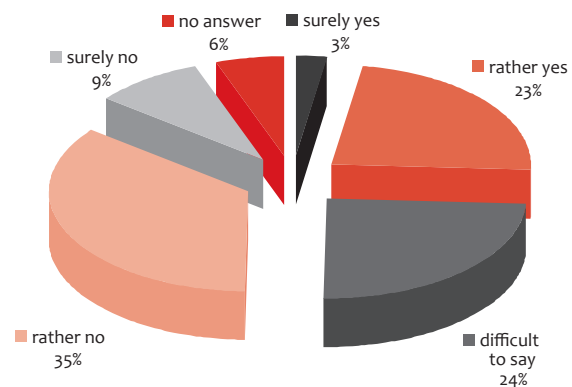
Quite a worrying distribution of answers and much worse than in 2007! The big share of "difficult to say" should not be interpreted in a neutral way. Youth and those with more advanced education background tend to be more pessimistic regarding their rights as compared the elderly and those with less advanced educational background.

In case your legitimate rights are violated, do you believe that justice system in our country would restore to you those rights?



Again, besides 43% of people having negative expectations, there is a large number of persons who cannot say accurately whether they trust or not the justice. Ethnic Russians and Ukrainians tend to have a more negative balance of answers than representatives of other ethnicities.

Do you believe that your personal and your family security is ensured in our country?



Interesting to note, the younger cohorts of the population feel more insecure than others. We believe this is related to the April 2009 political violence. Feelings of insecurity tend to abate as peoples incomes increase, and those residing in other communities than Chisinau feel generally less secure.

Compared to the situation 10 years ago, what do you think about the family relations in the Republic of Moldova today?

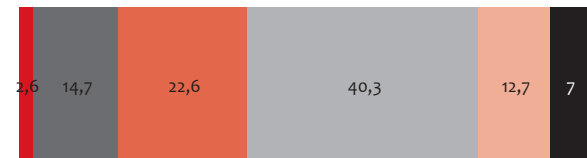
Families are much more united
 There is no difference
 There is acute deterioration of relations
 Families are a bit more united
 Family relations seem to worsen
 no answer



Moldovan women are more pessimistic than men regarding the families' strength. Lack of job and smaller income appear as significant factors weakening family ties. Also, for the traditional Moldova society, it is a surprise that rural dwellers perceive a more severe worsening of family relations than urban ones.

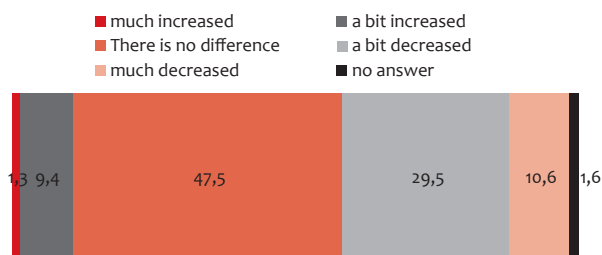
Thinking about the conditions determining the decision of young families to have children, what is your opinion about those conditions today in comparison with last year?

much better
 There is no difference
 much worse
 slightly better
 slightly worse
 no answer



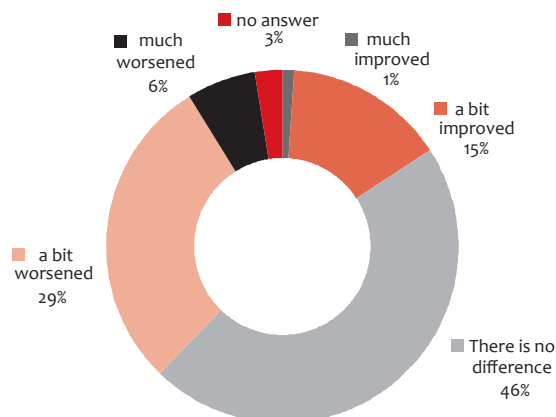
Quite interesting, the younger ones are less pessimistic than the older ones regarding young families having a child. Those enjoying higher income are more positive about family growth as well. A very negative balance of answers of the villagers is in line with depressing demographic trends there and with their destitute economic situation.

How has your income changed this year in comparison with the previous year?



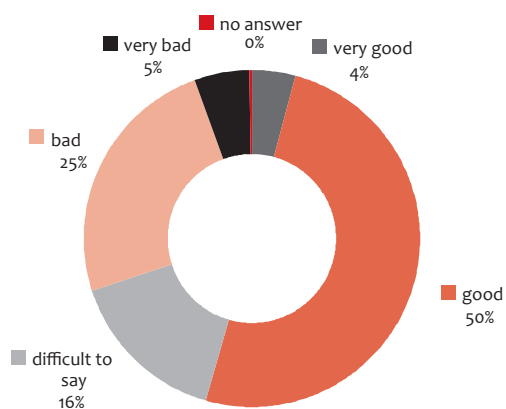
Due the economic recession income declined across the board in 2009. However, the capital area was less hit than periphery, which to certain extent correlates with the polarized economic growth that we have seen so far. Rural dwellers and the poor were the most severely affected.

How have you living standards changed this year in comparison with the previous year?



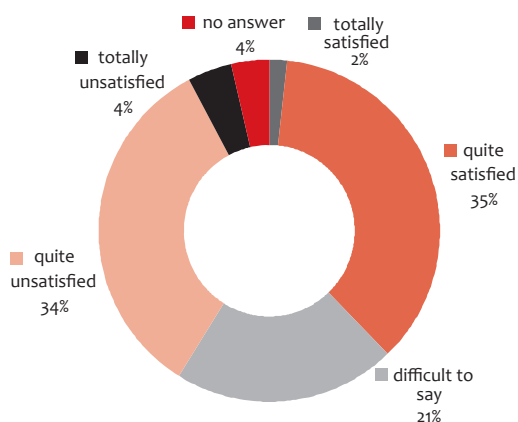
Standards of living are perceived to have suffered a bit less than income, but balance is negative again. The same correlations hold in case of living standards as in case of income. The eye-catching fact is households enjoying higher income improved their living standards in 2009.

How do you appreciate your health status?



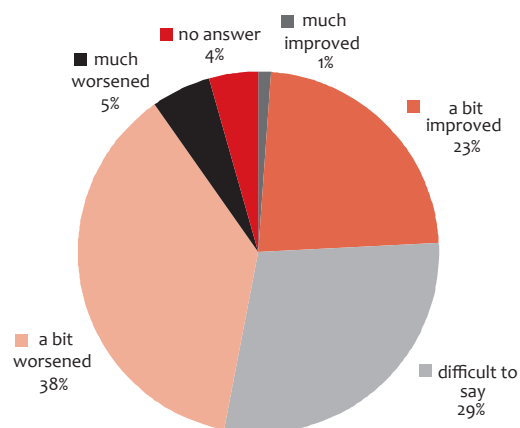
Well, if not rich, at least healthy. Normally, balance of answers turn from positive for youth to negative for elderly. Unemployment, rural residency and lower level of income clearly associates with a poorer health situation.

How satisfied are you with the quality of environment?



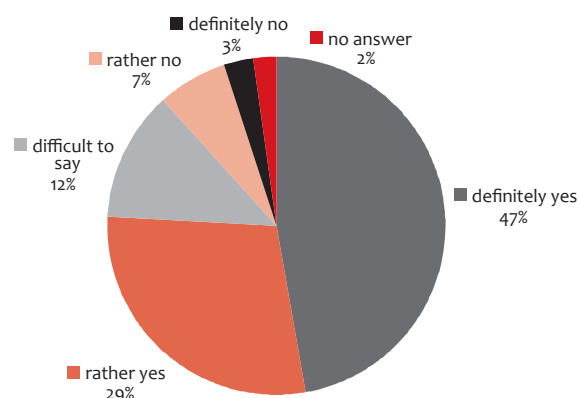
General balance of answers is marginally negative. While rural inhabitants enjoy cleaner environment than urban ones in general, it is striking that people in Chisinau are positive about the state of environment.

How do you appreciate the evolution of environment quality in the last 3 years?



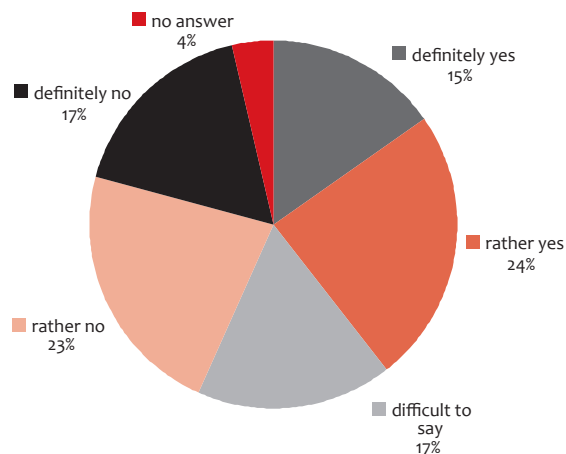
Everybody in Moldova seems to be equally displeased about the environment dynamics in the last 3 years. However, situation appears much worse in small towns than everywhere else.

Would you like your children or grandchildren to live in the Republic of Moldova?



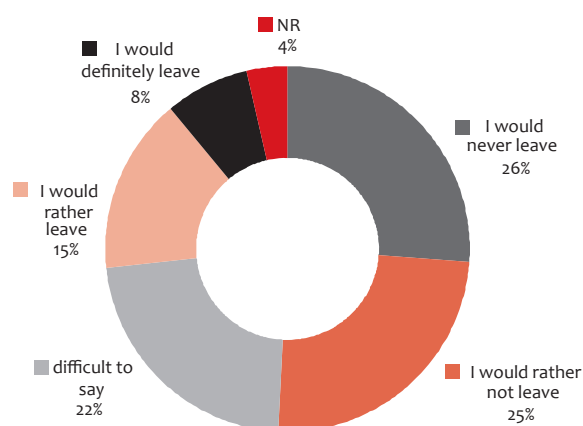
Despite its problems, Moldova seems to be a country sought for living, at least by its citizens. Do people really like this country and trust its future, if not its present? Apparently, yes, but it is noticeable that elderly are more willing than the youth to see their offspring remaining in the country.

If you had the opportunity to emigrate to work abroad in the next 3 months, would you accept it?



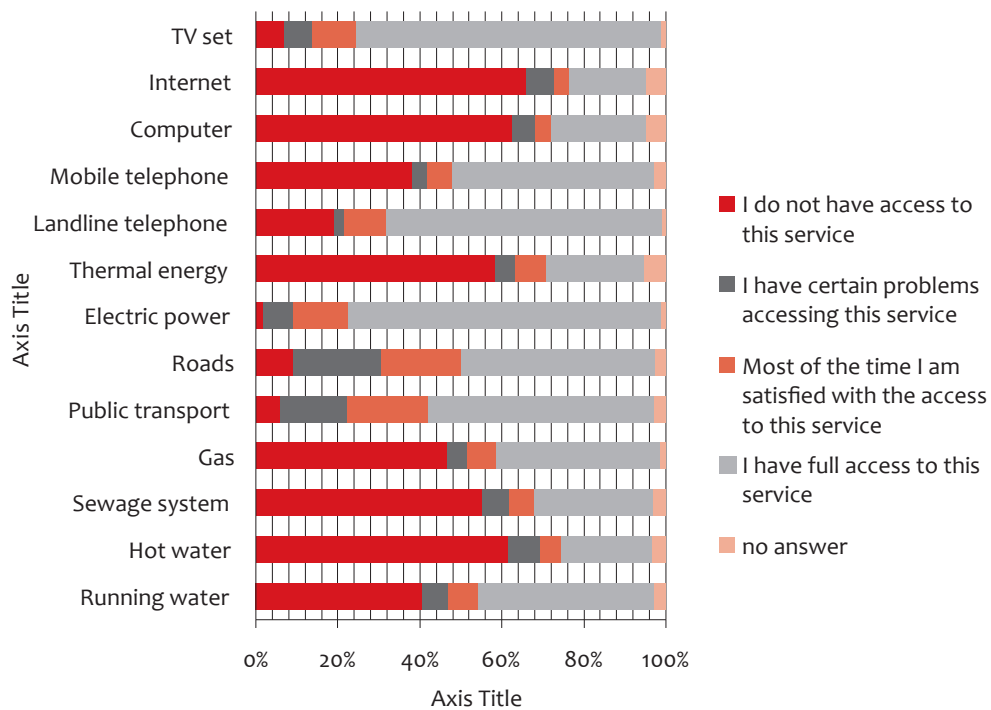
Moldovans like their country in long-run (see previous and next questions), but in the short one many of them – especially women, mid-aged and elderly, with lower educational profile, rural - would like to get out for a more decent job. Chisinau residents are less frantic in this respect.

Should you have the opportunity to leave Moldova for good, together with your family, in order to start a new life, what would you choose to do?



Even though many Moldovans would not refuse the opportunity to make some money abroad, they are not ready to leave Moldova for good. This is less true in case of the youth, with slightly more than half of them willing to settle abroad. Rural inhabitants are more than others tied to their homeland.

Which answer describes the best situation of your household regarding access to the following services and technologies



No comments.

About Expert-Grup

Expert-Grup is an independent think-tank from the Republic of Moldova. It has been actively working in Moldova since 2005. Its institutional mission is to contribute to the economic, political and social development of the Republic of Moldova as well as to support consolidation of the country's international competitiveness. Expert-Grup aims to accomplish this mission by delivering top quality analytical services and promoting efficient, transparent and innovative models in economic and social policies.

Expert-Grup is part of the PASOS network of policy centers reuniting about 40 think-tanks from more than 20 European countries.

As part of its permanent activity, Expert-Grup provides the public with relevant and most up-to-date analysis on economic and social policies; assists the decision-making and policy-making processes and promotes innovative development models. Expert-Grup has knowledge and extensive experience in the following areas: development strategies; macroeconomics and economic systems; global economy and international economic relations; economy of the European integration; monetary and fiscal policies; labor economy, management and business culture; consumer behavior; industrial and agricultural economics; economy of health and education.

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